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T. C. Memo. 1986-245

UNITED STATES TAX COURT

SANDRA G. PHILLIPS, Petitioner v. COMMISSIONER OF INTERNAL
REVENUE, Respondent

Docket No. 9347-84.

Filed June 17, 1986.

For 1980, P claimed a deduction for the expenses of operating her automobile in her business. The Commissioner disallowed such deduction in part. Held, P has failed to prove that she is entitled to a larger deduction than that allowed by the Commissioner.

Lane McDaniel, for the petitioner.

Joy C. Al-Sofi, for the respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

SIMPSON, Judge: The Commissioner determined a deficiency of \$609.22 in the petitioner's Federal income tax for 1980. The issue for decision is whether the petitioner has proved that she used her automobile in her business to the extent claimed by her on her return for 1980.

FINDINGS OF FACT

Some of the facts have been stipulated, and those facts are so found.

The petitioner, Sandra G. Phillips, maintained her residence in Dallas, Tex., at the time she filed her petition in this case. She filed her Federal income tax return for 1980 with the Internal Revenue Service Center, Austin, Tex.

Throughout 1980, the petitioner was a salesperson at the Murray Insurance Company. She resided 4 miles from her place of employment. In her work, she used an automobile to call upon customers and to make deliveries. On January 1, 1980, she owned a 1979 Mazda, and on October 1, 1980, she traded such automobile for a 1978 Cadillac.

From 1978 to 1983, the petitioner kept a daily log showing her appointments, but the log for 1980 has been misplaced. In the log, she recorded the mileage on the odometer of her automobile at the beginning and ending of

the year, but she did not record the mileage for each of her trips. She spent much of her working time in her automobile, and she believes that more than 90 percent of the use of that car was for business purposes. She had another automobile available to her, and she claims that she used the other automobile for her personal trips, although she admits that the business automobile was occasionally used for personal purposes.

The petitioner did keep a daily diary of her business travel from September 5, 1983, through December 25, 1983. It shows the business trips that she made each day and the mileage for each trip. It reveals only one personal trip, and the information concerning her commuting between her residence and her office is confusing. According to the diary, she used the automobile for a total of 5,006 miles during such period, or an average miles per day of 73.

On her Federal income tax return for 1980, the petitioner claimed a deduction of \$10,240 for the use of her automobile in her business. In computing such deduction, she claimed that she drove her automobile a total of 42,547 miles and that 90 percent of such use was for business purposes. She claimed actual expenses of \$3,355 for gas and oil, \$2,364 for other expenses such as tags, insurance, and miscellaneous, \$4,592 for depreciation, and \$500 for tolls and parking. In computing the deduction, the petitioner

took 90 percent of the costs for gas, oil, and the item described as "other" expenses.

In the notice of deficiency, the Commissioner recomputed the petitioner's deduction for automobile expenses and allowed only \$5,590. The petitioner furnished the IRS with information concerning the use of her business automobile for the period March 28 through April 13, 1983. During that period, 80 percent of the use of her automobile was for business purposes, and she used her automobile an average of 67 miles a day for business purposes. Using that daily average, the IRS determined that she used her automobile a total of 16,972.5 miles per year for business, but they allowed her an annual usage of 18,000 miles. She was able to substantiate expenses of \$632.81 for the item described as "other" expenses and \$125.00 for parking and tolls. The IRS used her figures to compute an allowance for gas and oil of 7 cents a mile for the Mazda and 10 cents a mile for the Cadillac, and he readjusted the depreciation allowance as a result of uncontested adjustments to the bases of the automobile. The petitioner was allowed 80 percent of the item described as "other" expenses and the depreciation.

OPINION

The sole issue in this case is whether the petitioner has proved that she is entitled to a larger deduction for

the use of her automobile in her business than that allowed by the Commissioner. An employee is entitled to deduct all the ordinary and necessary expenses of operating his automobile in his trade or business. Sec. 162, Internal Revenue Code of 1954¹; sec. 1.162-1(a), Income Tax Regs. The Commissioner recognizes that the petitioner used her automobile in her trade or business and is entitled to a deduction for some expenses attributable to such use. However, he has recomputed the allowable deduction, and the petitioner has the burden of proving that his computation is incorrect. Rule 142(a), Tax Court Rules of Practice and Procedure; see Johnson v. Commissioner, 77 T.C. 876 (1981); Focht v. Commissioner, 68 T.C. 223 (1977).

The Commissioner's computation was based upon a diary kept by the petitioner for a period of approximately 2 weeks in early 1983. It showed total miles driven and the miles driven for business purposes. Whereas for 1980, the petitioner merely made a record of her mileage at the beginning and ending of the year; she claims to have kept a log of her appointments, but she admits that she kept no daily record of the total miles driven and the miles driven for business purposes. Her computation for 1980 was based simply on her estimate of the miles driven for business purposes.

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All statutory references are to the Internal Revenue Code of 1954 as in effect during the year in issue.

Although the petitioner used her automobile primarily for business, it was not exclusively so used. The petitioner admittedly used the car to commute from her home to her place of business, and such commuting expenses are not deductible. Sec. 1.162-2(e), Income Tax Regs. Furthermore, the petitioner admittedly used her automobile for occasional personal uses which are also not deductible. Sec. 262.

In addition, the daily diary kept for the period from March 28 to April 13, 1983, and for the period from September 5 through December 25, 1983, does not support the petitioner's claim. These records were made contemporaneously and reflect the total miles driven by her and the miles driven for business. She claimed that her practices were the same in 1980 as in 1983, and these records suggest that she did not travel more than 18,000 miles a year for business purposes, although she claimed business travel of 38,292 on her return for 1980. The Commissioner's 80-percent figure was based on the record for the earlier period. Although the record for the latter period shows virtually no personal travel, we wonder at its completeness in view of the petitioner's admission that she used the car occasionally for personal purposes. The record for the latter period supports the Commissioner's determination as to the total miles driven during the year

and does not adequately refute the use of the 80-percent allocation.

On this record, we must sustain the Commissioner's determination. Wilkinson v. Commissioner, 71 T.C. 633 (1979); Figueiredo v. Commissioner, 54 T.C. 1508 (1970), affd. in an unpublished order (9th Cir., March 14, 1973, 73-2 U.S.T.C. par. 9713).

Decision will be entered
for the respondent.

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T. C. Memo. 1986-246

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UNITED STATES TAX COURT

DON E. NELL, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 26184-83.

Filed June 17, 1986.

Robert J. Degroot and Robert J. McKenna (specially recognized), for the petitioner.

Daniel K. O'Brien and William S. Garofalo, for the respondent.

MEMORANDUM FINDINGS OF FACT
AND OPINION

KÖRNER, Judge: Respondent determined deficiencies in petitioner's individual income tax for the calendar years 1968 and 1969 in the respective amounts of \$66,225.39 and \$4,178.86,

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together with additions to tax for each year under the provisions of section 6653(b)1/ in the respective amounts of \$33,112.69 and \$2,089.43. By amendment to his answer filed at the time of trial, respondent affirmatively alleged, in the alternative, that if respondent's determination of additions to tax under section 6653(b) were disapproved, petitioner was liable for additions to tax for each year under the provisions of section 6651 and section 6653(a). The issues which we must determine are:

1. Whether petitioner filed an income tax return for the calendar year 1968;
2. Whether petitioner had unreported taxable income in the years 1968 and 1969, resulting from certain sales of stock owned by petitioner in each year, as well as additional income from certain unidentified bank deposits in the year 1968;2/
3. Whether petitioner is liable for additions to tax for fraud, under section 6653(b), for either or both of the years 1968 and 1969; and

1/ All statutory references are to the Internal Revenue Code of 1954, as in effect in the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, except as otherwise noted.

2/ In addition to the above determinations, respondent determined additional income against petitioner for the year 1979 as unreported rental income. Although such item was placed in issue by petitioner's petition herein, the matter was addressed neither at trial nor on brief, and is deemed to be conceded.

4. In the alternative, in the event that additions to tax under section 6653(b) for either year are disapproved, whether petitioner is liable in either such year for additions to tax under section 6651(a) and/or section 6653(a).

The evidence herein was stipulated in part, and such facts, together with stipulated exhibits, are incorporated herein by this reference.

FINDINGS OF FACT

At the time of filing his petition herein, petitioner Don E. Nell was a resident of Elizabeth City, North Carolina. For the calendar year 1968, petitioner timely filed an individual income tax return as an "unmarried head of household," although at that time he was married to Audrey Nell. Such return showed a total tax liability of \$2,545.17. After correcting such amount to \$2,311.11 because of a mathematical error, respondent assessed the tax and credited petitioner's account for payment thereof through payments by petitioner and withholding on his salary, as reported. Said return reported, inter alia, wages or salary of \$16,000 and a net loss from certain rental property in the amount of \$1,663.93. No income from dividends or interest was reported, nor any capital gains or losses. For the year 1969, petitioner did not file an income tax return.

From approximately 1962 through October of 1967, petitioner was vice president of Datacomp Service Corporation, Inc., a New York corporation. In the early part of November 1967 a new

corporation of the same name, Datacomp Service Corporation, was formed in the State of New Jersey and took over all of the assets and liabilities of the New York corporation. On November 16, 1967, the new New Jersey corporation (hereinafter "Datacomp") issued 31,625 shares of its common stock to petitioner, in return for petitioner's promissory note payable to Datacomp in the amount of \$3,162.50.

On May 9, 1968, Datacomp entered into an agreement with the Dumont Corporation of Salt Lake City, Utah, (hereinafter "Dumont") whereby Dumont "purchased" all of the assets of Datacomp in exchange for 3,563,573 shares of class A common stock and 330,349 shares of class B common stock of Dumont. In connection with this acquisition, the original shareholders of Datacomp received 5.2 shares of Dumont stock for each share of Datacomp common stock held. As the result of this exchange of stock, petitioner, as of May 10, 1968, owned 167,050 shares of class A common stock of Dumont. On that same date, petitioner was elected vice president and a director of Dumont. Petitioner was named president of Dumont in August of 1968 and continued in that capacity through November 30, 1968, when he terminated his connection with Dumont.

After the May 9, 1968, acquisition of Datacomp by Dumont, the bid price for Dumont stock on the open market increased in accordance with the following listed summary:

<u>Date</u>	<u>Bid Price</u>
May 3, 1968	1 3/8
May 16, 1968	3 3/4
June 16, 1968	9 1/4
October 15, 1968	10 1/2

Orders suspending all trading in securities of Dumont were issued by the Securities and Exchange Commission on November 1, 1968.

Margarete Contento (hereinafter "Contento") is a woman who for part of 1968 worked as a waitress in a restaurant in Englewood Cliffs, New Jersey. She worked for a salary and tips. In 1969, she was unemployed. She is a woman of limited education and little, if any, knowledge of investment, financial and tax affairs. She had no significant funds of her own. At some point in 1968, petitioner formed a liaison with Contento and moved in to her rented apartment in Paterson, New Jersey, where he lived with her as man and wife, together with Contento's son and two grandchildren. In 1969, petitioner, Contento, et al., moved to a single family house in Creskill, New Jersey. In the latter part of 1969, the house was damaged by fire, at a time when petitioner and Contento were absent.

At some point in 1968, and after receiving his 167,050 shares of Dumont stock, petitioner caused one-half thereof, or 83,525 shares, to be transferred to the name of Contento.^{3/} The

^{3/} Contento testified that she received about 80,000 shares, using a round figure. Petitioner testified that he caused his shares to be divided equally, with one half being put in the name of Contento. We accept petitioner's testimony on this point as being more precise.

latter paid no consideration for the transfer of said stock to her, and at all relevant times acted as petitioner's nominee and subject to his direction and control, with respect to the stock and any proceeds therefrom.

Petitioner caused Contento to open a stock brokerage account in 1968 in her name with the firm of Hardy & Company. Through this account, in the period August 30, 1968, through December 3, 1968, petitioner caused Contento to sell the following stocks at various times, in the following total amounts:

<u>Shares and Company</u>	<u>Cost^{4/}</u>	<u>Sales Price</u>
6,900 Dumont	\$ 690.00	\$ 58,695.13
1,000 Spooner Mines	2,835.00	3,755.00
200 National Food Marketers	2,933.50	2,354.50
200 Addressograph-Multigraph	17,933.34	<u>15,076.49</u>
	TOTAL SALES	<u>\$ 79,881.12</u>

During that same year, Hardy & Company made disbursements to Contento with respect to transactions through the account in the total amount of \$55,679.89, which were deposited in various bank accounts maintained in the name of Contento. Petitioner actively participated in maintaining the check ledgers and in drawing checks for Contento's signature, and substantial amounts from these accounts were paid to him or for his benefit.

^{4/} Conceded on brief by respondent.

In 1968, petitioner caused Contento to open a stock brokerage account with the firm of Merrill, Lynch, Pierce, Fenner & Smith, Inc. During the period June 25, 1968, through December 31, 1968, petitioner caused Contento to make the following sales of stocks through this account, at the following prices:

<u>Shares and Company</u>	<u>Cost^{5/}</u>	<u>Sales Price</u>
1,600 Dumont	\$ 160.00	\$ 12,552.42
100 National Food Marketers	1,496.75	<u>1,350.50</u>
	TOTAL SALES	<u>\$ 13,902.92</u>

During the year 1968, Merrill, Lynch, Pierce, Fenner & Smith, Inc. made disbursements to Contento with respect to sales of stock through the account in the total amount of \$13,902.42. Of this amount, two checks totaling \$5,394.61 were cashed, and the balance was deposited in various bank accounts maintained in the name of Contento.

In 1968, petitioner caused Contento to open a stock brokerage account with the firm of Orvis Bros. & Co. In 1969, petitioner caused Contento to sell 3,000 shares of Silver Mac Mines stock through this account, with a cost of \$1,103.63, at a sales price of \$1,562.26.

During the year 1969, Albert W. Dugan of Houston, Texas, purchased Dumont Corporation stock on three occasions, as follows:

^{5/} See n. 4, supra.

(a) On or about April 14, 1969, Mr. Dugan paid petitioner \$7,000 for an undisclosed number of shares of Dumont.

(b) On July 14, 1969, Mr. Dugan paid petitioner \$5,000 for the purchase of 10,000 shares of Dumont.

(c) On August 18, 1969, petitioner and Contento appeared personally in Mr. Dugan's office in Houston, Texas, at which time Mr. Dugan delivered a cashier's check to petitioner in the amount of \$2,500 for the purchase of 10,000 shares of Dumont, and a further cashier's check in the amount of \$5,000 for the purchase of 20,000 shares of Dumont, said check being payable to Contento at petitioner's direction.

The above sales of Dumont stock to Mr. Dugan were negotiated on his behalf by a Mr. Gearhart (now deceased) who was a personal friend of Mr. Dugan's.6/

The same Mr. Gearhart was also a friend of a Dr. William Bloom who, in 1969, was a practicing physician in New York City. Apparently through the intermediation of Mr. Gearhart, Dr. Bloom purchased Dumont stock from petitioner (whom he never met) on or about October 1, 1969, at a price of \$2,000 for an undisclosed number of shares.7/

6/ Respondent on brief conceded a cost basis of \$600 in this stock.

7/ Respondent on brief conceded a cost basis of \$100 in this stock.

On or about September 12, 1969, one William Howard (now deceased) purchased 12,000 shares of Dumont stock which was registered in the name of Contento for a price of \$3,000. The sale was arranged by Mr. Howard's brother, Charles Howard, with petitioner, with the participation in some undisclosed fashion of Dr. Bloom and Mr. Gearhart.^{8/}

The purchase of the house at Creskill, New Jersey, in which petitioner and Contento lived in 1969, was arranged by petitioner, with title thereto being put in Contento's name. Contento supplied no funds of her own for this purchase, and all necessary funds were supplied by petitioner through accounts maintained in the name of Contento, described above.

In his statutory notice of deficiency herein, respondent determined that petitioner had unreported short-term gains from the sale of securities in 1968 as follows:

<u>Description</u>	<u>Broker</u>	<u>Cost</u>	<u>Number of Shares</u>	<u>Short Term Gain or Loss</u>
Spooner Mines	Hardy & Co.	\$ 2,835.00	1,000	\$ 920.00
National Food Market	Hardy & Co.	2,993.50	200	(639.00)
National Food Market	MLPF&S*	1,496.75	100	(146.25)
Addressograph- Multigraph	Hardy & Co.	17,933.34	200	(2,836.85)
Dumont Corp.	Hardy & Co.	-0-	6,900	58,695.13
Dumont Corp.	Hardy & Co.	-0-	1,600	15,232.16
Dumont Corp.	MLPF&S*	-0-	1,600	12,552.42
Total Short Term Gain				<u>\$83,777.61</u>

[*Merill, Lynch, Pierce, Fenner & Smith]

^{8/} Respondent on brief conceded a cost basis of \$100 in this stock.

In his statutory notice herein, respondent determined that petitioner had unreported long-term capital gains from the sale of securities in 1969 as follows:

<u>Description</u>	<u>Shares</u>	<u>Cost</u>	<u>Selling Price</u>
Dumont Corp.	24,000	-0-	\$14,500.00
Dumont Corp.	8,000	-0-	2,000.00
Dumont Corp.	12,000	-0-	3,000.00
Dumont Corp.	10,000	-0-	2,500.00
Dumont Corp.	10,000	-0-	3,000.00
Dumont Corp.	20,000	-0-	5,000.00
National Food	100	\$1,522.00	1.75
Silver Mac Mines	3,000	1,103.63	458.63
Total Long Term Capital Gain			\$30,460.38
Less: Section 1202 deduction - 50%			(15,230.19)
Taxable Long Term Capital Gain			<u>\$15,230.19</u>

In his statutory notice herein, respondent determined that petitioner had unreported income in 1968 from unexplained bank deposits in the following bank accounts on the following dates, in the following amounts:

<u>Bank</u>	<u>Date of Deposit</u>	<u>Amount</u>
Englewood National Bank	7/30/68	\$ 2,500.00
Acct. #301-00421-8	9/09/68	5,974.29
Kings County Lafayette Trust	11/04/68	2,000.00
Acct. #03-005-2866		
Fort Lee Trust Co.	4/10/68	1,000.00
Acct. #01-4950-0	10/24/68	2,000.00
	11/01/68	2,000.00
	12/13/68	2,000.00
Total Unidentified Unreported Income		<u>\$17,474.29</u>

With respect to the bank accounts in the above table, the Englewood National Bank account was maintained in the name of Contento; the Fort Lee Trust Co. account was in the name of petitioner; and the name in which the account at Kings County Lafayette Trust was maintained is not disclosed in this record.

There was an underpayment of tax by petitioner in each of the years 1968 and 1969, some part of which was attributable to fraud.

OPINION

Respondent determined in his notice of deficiency that petitioner had unreported taxable income in the form of short-term gains from the sales of securities in 1968, as well as from certain unidentified bank deposits in that year. For 1969, respondent further determined that petitioner had unreported income from long-term capital gains resulting from the sales of certain other securities. These specific adjustments to petitioner's income for both years were detailed in respondent's statutory notice of deficiency, as shown in our findings of fact. The burden of proof was on petitioner to show error in respondent's determinations with respect to these adjustments, Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a). So far as petitioner is concerned, he has failed to carry that burden of proof.

With respect to respondent's determination of securities sales in 1968, the records of the various brokerage houses, as detailed in our findings of fact, were introduced in evidence, and through them the sales of the relevant securities could be traced. For 1969, the same evidence was in the record, together with the direct testimony of Contento and other third-party witnesses with regard to the individual direct sales of Dumont stock in that year to Messrs. Dugan, Bloom and Howard.

We think that the evidence in this record -- mostly in the form of joint exhibits or testimony and evidence introduced by respondent -- clearly substantiates the bulk of the determinations with regard to securities sales, as determined by respondent. The evidence shows, as we have found, that in 1968 petitioner caused half of his Dumont shares to be put in the name of Margarete Contento, and that at all relevant times Contento served as petitioner's nominee or straw party for the purpose of effecting sales of securities which were really the property of petitioner. As part of this device, petitioner caused Contento to open and maintain various bank accounts, through which the proceeds of these sales, as well as perhaps other funds, flowed. The securities, and the proceeds of sales of securities, were nevertheless the property and the income of petitioner.

Against this pattern of evidence, both documentary and through the testimony of witnesses at trial, petitioner, who had the burden on these issues, produced no evidence at all, except his unsupported and self-serving testimony that he had nothing to

do with establishing the brokerage accounts in Contento's name, did not control the activity therein and had nothing to do with the various bank accounts which Contento maintained.

Petitioner's testimony at trial was vague, evasive, and frequently contradictory, and we find it generally unworthy of belief. Petitioner simply adopted the tactic of "stonewalling." He repeatedly declined to identify his signature as endorsements on numerous checks made out to him which were presented to him at trial, on the grounds that he could not identify his signature because he was not a handwriting expert. One does not have to be a handwriting expert in order to identify his own signature, and we are satisfied that petitioner was simply not telling the truth when he refused to identify his signature on the various checks which were presented to him in the course of trial.

Again, in the face of direct and explicit testimony, both of Mr. Dugan and of Contento -- that they had met with petitioner in Houston, Texas, on a certain day, at which time Mr. Dugan bought Dumont stock, some registered in petitioner's name and some registered in Contento's name -- petitioner flatly denied that he had ever gone to Houston or had ever met Mr. Dugan. We think the weight of the evidence herein proves the contrary.

Again, petitioner denied at trial that he had ever filed a tax return for 1968, and denied what clearly appeared to be his signature on such return when it was introduced in evidence. Petitioner, however, never denied having filed a 1968 tax return up until the time of trial, including numerous prior interviews

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with respondent's agents with respect to his 1968 and 1969 tax affairs. Furthermore, petitioner on brief requested us to find that he had filed a Form 1040 for 1968, and at no time has petitioner ever disclaimed the credits to his 1968 account given by respondent based upon that return and the withholding and tax payments made therewith.

Other instances in this record abound of petitioner's flat denials or evasions of facts which are otherwise clearly established in the record.

We are the trier of facts. It is our duty to listen to the testimony, observe the demeanor of the witnesses, weigh the evidence, and determine what we will or will not believe. We are not required to accept testimony at face value, and we may discount a party's self-interested testimony, and place our reliance on other testimony which we believe is more reliable. See Christensen v. Commissioner, 786 F.2d 1302 (9th Cir. 1986), affg. and remanding T.C. Memo. 1984-197; Weiss v. Commissioner, 221 F.2d 152 (8th Cir. 1955); Archer v. Commissioner, 227 F.2d 270 (5th Cir. 1955).

We have accepted, then, that the securities sold through Contento's various brokerage accounts in 1968 and 1969 were in fact the securities of petitioner, and that the income was his, as determined by respondent, with the following exceptions:

A. For the year 1968, our findings show the amounts of sales of securities, the prices received therefor and the costs, either as determined by respondent in his statutory notice or as

conceded on brief, with the exception of the alleged sale of 1,600 shares of Dumont stock through the Firm of Hardy & Co., at a price of \$15,232.16. With respect to this item, the transcript of the Hardy & Co. brokerage account, which was introduced in evidence, shows that no such sale took place. With respect to this item, therefore, respondent's determination is disapproved. As to the rest of the securities sales in 1968, the determination is approved.

B. For the year 1969, the evidence, plus respondent's concessions as to costs, establishes the basis for our findings with regard to the sale by petitioner in that year of \$24,500 worth of stock of Dumont as well as the stock of Silver Mac. As to the additional \$5,500 worth of Dumont stock as well as the National Food Marketers stock, as determined by respondent in his notice of deficiency, there was no evidence, and respondent has omitted this from his requested findings of fact, which we interpret as a concession on respondent's part as to these items. In other respects, therefore, respondent's determination of securities sales in 1969 is approved, in accordance with our findings of fact.

With respect to respondent's determination of additional income from unidentified bank deposits for the year 1968, petitioner simply offered no evidence of any sort on this point, and respondent's determination must therefore be approved for failure of petitioner to carry his necessary burden of proof with respect thereto. In this connection, however, we note that

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respondent went to considerable lengths, which we find convincing, to demonstrate that such unidentified bank deposits did not come from the proceeds of stock sales so as to cause a duplication of income against petitioner for 1968.

We turn now to the issue of respondent's determined additions to tax for fraud against petitioner for both years, under the provisions of section 6653(b). Here, the burden of proof is upon respondent to show fraud by clear and convincing evidence, sec. 7454, Rule 142(b). Fraud, as used in section 6653(b), means actual intentional wrongdoing. Mitchell v. Commissioner, 118 F.2d 308 (5th Cir. 1941). The intent required is a voluntary, intentional violation of a known legal duty; in this case, to evade a tax believed to be owing. Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir. 1968), cert. denied 393 U.S. 1020 (1969); Estate of Temple v. Commissioner, 67 T.C. 143, 159 (1976), appeal dismissed (5th Cir. 1977). Where direct evidence of fraudulent intent is not available, its existence may be determined from the conduct of the petitioner and the surrounding circumstances. Stone v. Commissioner, 56 T.C. 213, 223-224 (1971). The Supreme Court has stated that an "affirmative willful attempt may be inferred from * * * any conduct, the likely effect of which would be to mislead or conceal." Cf. Spies v. United States, 317 U.S. 492, 499 (1943).

Considering all the evidence in this case as a whole, we are satisfied that respondent has carried his necessary burden of proof on the fraud issue as to both years. We are satisfied that

in the transactions which we have described in our findings, Contento acted under the control and direction of petitioner, and as his nominee; that she had no funds of her own; and that petitioner used her to screen his receipt of income from sales of securities which he owned. The evidence shows that petitioner was a mature and sophisticated businessman, who at one time had held a high position with a major company. We think that he knew exactly what he was doing and what he intended to accomplish, which was the evasion of income tax on substantial income in both the years 1968 and 1969. In the face of clear and convincing evidence to this effect, we find his bald-faced denials at trial singularly unconvincing.

For the years before us, the precise amount of underpayment resulting from fraud need not be proved. Otsuki v. Commissioner, 53 T.C. 96 (1969). The statute requires only a showing that "any part" of an underpayment results from fraud. We accordingly sustain respondent on the fraud issue.

Given our disposition of the fraud issue, respondent's alternative claims for additions under sections 6651(a) and 6653(a) need not be considered.

Decision will be entered
under Rule 155.

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T. C. Memo. 1986-247

UNITED STATES TAX COURT

ESTATE OF MAYNARD C. WEDUM, DECEASED, NORTHWESTERN NATIONAL BANK
OF MINNEAPOLIS, EXECUTOR, Petitioner v. COMMISSIONER OF INTERNAL
REVENUE, Respondent

Docket No. 4970-83.

Filed June 18, 1986.

David R. Brennan and Robert W. Oelke, for the petitioner.

Sue Ann Nelson, for the respondent.

MEMORANDUM OPINION

WILBUR, Judge: This case is before the Court on
petitioner's motion for partial summary judgment filed pursuant
to Rule 121, Tax Court Rules of Practice and Procedure.¹

Respondent determined a deficiency in petitioner's estate
tax in the amount of \$331,118.99.

Maynard C. Wedum (decedent) died on October 15, 1978.

Northwestern National Bank of Minneapolis (petitioner) was named executor of his estate. On January 15, 1980, a Federal estate tax return was filed with respondent. Petitioner paid the reported estate tax in the amount of \$279,244.72, plus interest.

The last will and testament of decedent provided for the following bequests: To his surviving spouse, Mabel Wedum, all automobiles, furniture or articles of personal property, a life estate in decedent's homestead, and payments of income from a testamentary trust equal to 25 percent of decedent's residuary estate. Decedent also made a specific bequest of \$400,000 to his daughter, Carola Palm. The residue of decedent's estate passed to the Wedum Foundation, a qualified charitable organization.

During the course of respondent's examination of the decedent's estate tax return, respondent discovered that the decedent's son, John A. Wedum, had been tried on a charge of Federal income tax evasion in the United States District Court for the District of Minnesota in March 1977. At that trial (in which decedent testified as a Government witness), frequent references were made to six inter vivos trusts established by decedent. Further examination by respondent disclosed the existence, on the date of decedent's death, of a John A. Wedum Trust (son of decedent), a Carola Palm Trust (daughter of decedent), and four separate trusts for decedent's grandchildren (hereafter the "Palm Trusts"). Prior to the filing of the estate

tax return, John A. Wedum, Carola Palm and each of the Palm grandchildren (Laura, Steven, John, and Robert) filed a claim against the decedent's estate for an accounting of their trust assets.

The Wedum Foundation also filed a claim against the estate, as the principal residual beneficiary, for an accounting and a disbursement to it of the funds to which it was entitled. A settlement agreement, dated July 23, 1981, provided for a distribution of assets as follows: John A. Wedum--\$300,000, Carola Palm--\$103,000, John Palm--\$55,500, Laura Palm--\$55,500, Steven Palm--\$55,500, and Robert Palm--\$55,500. The settlement agreement was signed by each of the trust beneficiaries, petitioner, and the Attorney General for the State of Minnesota.

In the estate tax return filed on January 15, 1980, petitioner reported a gross estate of \$4,569,052.63 and a charitable contribution in the amount of \$3,119,299.05. The \$625,000 in trust assets that were ultimately paid to John A. Wedum, Carola Palm, and the four grandchildren pursuant to the July 23, 1981 settlement agreement were included in the gross estate and in the charitable contribution deduction.

On July 19, 1982, an amended estate tax return was filed by petitioner. On Schedule K of the amended return, the estate deducted the value of the trust assets awarded pursuant to the settlement agreement from the gross estate as "Debts of Decedent."

On March 12, 1984, petitioner filed its motion for partial summary judgment, contending that the undisputed facts establish as a matter of law that the estate is entitled to a judgment based upon the exclusion from the gross estate of the \$625,000 in trust assets. To the contrary, respondent contends that these assets were properly included in decedent's gross estate as reported on petitioner's original estate tax return. Respondent further asserts that the estate's obligation under the settlement agreement does not qualify for a deduction pursuant to section 2053.²

Summary judgment pursuant to Rule 121 corresponds to Rule 56 of the Federal Rules of Civil Procedure and constitutes a procedural device designed to expedite the litigation process. Shiosaki v. Commissioner, 61 T.C. 861 (1974). See the Note to Rule 121, 60 T.C. 1127-1128 (1973). This device, however, is not intended to serve as a substitute for a trial on the merits. The effect of granting such a motion is to decide the controversy against the non-moving party without a trial. Therefore, "such motion should be 'cautiously invoked' and only granted after a careful consideration of the case." Shiosaki v. Commissioner, supra at 863.

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Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect on the date of decedent's death.

Rule 121(b) provides that a decision may be rendered on a motion for summary judgment if it is shown "that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law." The factual materials and the inferences drawn from such materials must be considered in a light most favorable to the party opposing the motion. Heyman v. Commerce and Industry Insurance Co., 524 F.2d 1317 (2d Cir. 1975); Gauntt v. Commissioner, 82 T.C. 96 (1984). Petitioner, as the moving party, has the burden of demonstrating that no genuine issue exists as to any material fact, and that it is entitled to a judgment as a matter of law. Addickes v. S.H. Kress and Co., 398 U.S. 144, 157 (1970); Gulfstream Land and Development Corp. v. Commissioner, 71 T.C. 587, 596 (1979).

This Court has held that it will deny a motion for summary judgment if there is any reasonable doubt as to the facts at issue. Hoeme v. Commissioner, 63 T.C. 18, 20 (1974). Applying these standards to the facts in this record and in a manner most favorable to respondent, we conclude that a genuine issue of material fact remains with respect to the inclusion of the trust assets in the decedent's gross estate.

Section 2031 defines the gross estate to include the value of all property, whether real or personal, tangible or intangible, to the extent provided for in sections 2033 through 2045. Section 2033 constitutes the basic inclusion provision and is somewhat analogous to the broad scope of section 61 which

defines gross income. Section 2033 provides that the gross estate "shall include the value of all property to the extent of the interest therein of the decedent at the time of his death." If the decedent possesses only a life estate or life interest which terminates upon his death, however, section 2033 will not cause the value of this interest to be included in the gross estate. Sections 2034 through 2045 are, therefore, designed to include in the gross estate property transferred during life where the decedent-transferor maintains some affinity with the property less than that which would cause the property to be includable in the gross estate pursuant to section 2033. Such transfers would otherwise escape the rather loosely woven net of section 2033.

It is respondent's contention that genuine issues of material fact remain relative to the decedent's alleged possession of and control over the trust assets, and that petitioner's motion for partial summary judgment should be denied. We agree with respondent.

The decedent established six trusts during his lifetime. Four of these trusts were created for the benefit of decedent's grandchildren (the Palm Trusts). The remaining two trusts were established for the benefit of his son (the John A. Wedum Trust) and his daughter (the Carola Palm Trust).

The Palm Trusts

On October 1, 1962, the decedent and his wife, Mabel, executed identical trust instruments for the benefit of their four grandchildren: Robert Palm, Steven Palm, Laura Palm, and John Palm. The decedent was the trustee of each of these four trusts, and each grandchild was the sole beneficiary of his or her own trust. The decedent and his spouse transferred assets to these four trusts having the following values: Laura Palm trust--\$21,000, Steven Palm trust--\$18,000, John Palm trust--\$24,000, and Robert Palm trust--\$12,000. Each of the four Palm Trusts included terms that provided for automatic termination of the trust upon the grandchild's 21st birthday. Upon termination of the trust, the beneficiary was to receive the remaining corpus and any accrued or accumulated income. If a beneficiary died prior to age 21, the trust corpus and any accumulated income was to be paid by the trustee to the estate of the decedent-beneficiary.

Each of the Palm Trust instruments evidences a reserved power in decedent, as trustee, to control the investment of the trust assets.³ The trust documents also indicate that decedent

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Article three of each of the Palm Trust instruments provides in pertinent part as follows:

[T]he Trustee * * * shall have full power and authority in his continuing discretion:

1. To receive any property, either real or personal from any other source and to retain cash or other
- (footnote continued)

retained the discretion as trustee to withhold payments of income.⁴ Petitioner asserts that, even assuming that the decedent retained a discretionary power to accumulate income, this power was effectively relinquished when decedent resigned as trustee in December of 1966. According to respondent, however,

(footnote continued from previous page)

assets for so long as he deems advisable, and to sell, exchange, lease or otherwise dispose of the same for terms within or extending beyond the termination of this trust, and to receive from any source additional properties acceptable to him.

2. To retain and to continue to hold, so long as he deems advisable, as part of the trust estate any assets delivered to the Trustee by the Trustors without liability for loss or depreciation by so doing.

3. To invest and reinvest in, or exchange assets for, any securities and properties he deems advisable, including, without limiting the generality of the foregoing, common and preferred stocks, whether or not of the kind or class authorized by law, and to commingle for investment all or any part of the funds of this trust in any common trust fund or funds maintained by the Trustee. * * *

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The relevant provision found in each of the Palm Trust documents provides as follows:

ARTICLE II.

The Trustee shall collect, receive, receipt for and manage the principal and income of the trust estate and, after paying the proper charges and expenses of the trust, the Trustee shall hold and distribute the principal of and the net income from the trust estate as follows:

A. The Trust estate shall be vested forthwith in the said _____, and the trust estate shall be retained in trust by the Trustee and the Trustee shall pay to the said _____, for his sole use and benefit, for any purpose whatsoever until said _____ attains the age of twenty-one (21) years, any part or parts of the

(footnote continued)

the decedent's purported resignation as trustee of the Palm Trusts was a sham. He alleges that no trust assets were transferred to the successor-trustee, John A. Wedum, and that such assets remained in decedent's exclusive possession. The decedent testified at his son's criminal tax trial that he maintained, even after his resignation, exclusive and unfettered control over the Palm Trust assets. Maynard Wedum also indicated that he intended for the Palm Trust assets to remain under his jurisdiction until his death. We note also that neither the Laura Palm Trust nor the Steven Palm Trust terminated in accordance with its governing instrument when each beneficiary reached the age of 21. Furthermore, the Palm Trust ledger sheets indicate that the trust income was not distributed currently and instead was accumulated until the decedent's death.

The Carola Palm and John Wedum Trusts

During the years commencing in 1946 and ending January 1, 1960, decedent established accounts in the name of John A. Wedum and Carola Wedum. These "accounts" were funded with the decedent's cash gifts, usually in an amount conforming to the

(footnote continued from previous page)

income or principal; provided, however, that said payments of any income or principal to or for the benefit of the said _____ are not intended to be, or shall any payment be made in lieu of or in discharge of, any parental obligation of the said Trustors or either of them. Any income from the trust not paid to or applied for the benefit of the said _____ shall be accumulated by the Trustee and added to the principal.
[Emphasis added.]

Federal and State gift tax exclusion. On January 1, 1960, grantor trusts were created for John A. Wedum and for Carola Palm (formerly Carola Wedum). John Wedum and Carola Palm were each designated as settlors of their own respective trusts. The decedent and attorney Robert Leach were named co-trustees. The John A. Wedum Trust was funded with a promissory note from "Local Gas of Alexandria, Inc." in the principal amount of \$60,000. The sole beneficiary of the John A. Wedum Trust was John A. Wedum or, in the event of his death, his children. The Carola Palm Trust was funded with a promissory note from "Albert G. Frahm and John A. Wedum, a partnership doing business as the F & W Company." The promissory note was issued in the principal amount of \$56,227.50. The sole beneficiary of the Carola Palm Trust was Carola Palm or, in the event of her death, her children.

It is respondent's contention, based on the decedent's sworn testimony at John A. Wedum's criminal tax trial, that all of the sums used to fund these two trusts came from the decedent's own personal assets. Generally, one who contributes property to a trust created by another is the true grantor to the extent of the contributions made. Buhl v. Kavanagh, 118 F.2d 315 (6th Cir. 1941); Lehman v. Commissioner, 109 F.2d 99 (2d Cir. 1940); Bogert, Trusts, sec. 41 at 428 (rev. 2d ed. 1984). "It is well established that the person who furnishes the consideration for

the creation of a trust is the settlor even though in form the trust is created by another." Blackman v. United States, 48 F. Supp. 362, 368 (Ct. Cl. 1943).

To the extent that it is ultimately determined that the decedent's assets were used to fund these two trusts, Maynard C. Wedum will be treated as the settlor. A determination of the identity of the true settlor of these two trusts is critical because the application of section 2036 is predicated on the decedent having made an inter vivos transfer of property or an interest in property.

The John A. Wedum and the Carola Palm Trust documents are essentially identical. They provide in pertinent part as follows: "Trustees shall distribute to the settlor so much of the net income of and from the Trust Estate as Trustee Robert F. Leach, in his sole discretion shall determine, accumulating any income not so distributed." The Carola Palm and the John Wedum Trusts each provided that upon the death of Maynard C. Wedum, John A. Wedum was to be nominated as successor trustee. Both trust instruments also provide that upon the death of trustee Robert Leach, the Northwestern Bank of Minneapolis was to be nominated as successor trustee. We note that although Mr. Leach in fact died nearly eight years prior to the decedent, the bank was never notified of its appointment as successor trustee. On September 28, 1964, the decedent purportedly resigned as trustee of the John A. Wedum Trust and John A. Wedum was nominated as his

successor. In the Federal District Court, however, the decedent indicated that he continued to act as trustee notwithstanding his pro forma resignation.⁵ He testified:

Q. And after you resigned who then took over as trustee?

A. Well, effectively even when Bob Leach was trustee, and even after I resigned, I--that was, what shall I call it, just an official designation. I handled it. [Transcript of Maynard C. Wedum's testimony given in March, 1977 in the United States District Court, District of Minnesota, p. 97 (hereafter "trial transcript").]

Decedent further indicated in his testimony that his intent was for the trust assets to be accumulated and given to the beneficiaries after his death.⁶ In addition, the decedent testified that he commingled the John A. Wedum and Carola Palm Trust assets with his own personal and business assets. (Trial

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We note that there is no evidence to indicate that the decedent resigned as trustee of the Carola Palm Trust.

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According to the following testimony of decedent, the trust assets were to be accumulated until his death at which time they were to pass to the trust beneficiaries.

Well, those Trusts were set up for this ultimate benefit as a tax expediency to accumulate funds from which they would become heirs to at the time of my passing, and they weren't for present use, and Timmy [Carola Palm] got the idea that since they existed they were available immediately * * *, and I tried to make her understand that the Trust wasn't for present use. * * *. So I told her that the Trusts were only to be used for the time of my eventual--my death, that they were not for present use * * *. [Transcript of Maynard C. Wedum's testimony given in March 1977 in the United States District Court, District of Minnesota, p. 124-125.]

transcript, supra at 123.) The decedent stated that he continuously held the assets used to fund these two trusts in his personal accounts over which he had sole signatory authority.

We note that petitioner raised an objection to the admission of that portion of respondent's affidavit which includes the transcript of decedent's testimony in the criminal tax trial of his son, John A. Wedum. The objection was made because, according to petitioner, the testimony was offered for the sole purpose of supporting inclusion of the trust assets in the gross estate under section 2033. Petitioner alleges that because section 2033 was not raised by respondent in the pleadings, it is beyond the scope of petitioner's motion for partial summary judgment. We disagree.

In its amended estate tax return, petitioner included the trust assets in decedent's gross estate and claimed that the estate should be allowed a deduction pursuant to section 2053. Respondent, in his notice of deficiency, accepted petitioner's treatment of the trust assets as part of the gross estate but denied the validity of the claims asserted under section 2053.

In its petition, the estate alleged for the first time that the assets should be excluded from the gross estate. Respondent, in his answer, denied generally that these trust assets should be excluded from the gross estate. We believe that petitioner's allegation, made in its petition, that the trust assets are not includable in the decedent's gross estate raises the issue of

includability under all of the pertinent Code provisions, including section 2033. Furthermore, we think the portion of the affidavit containing the transcript of the decedent's testimony is relevant to respondent's argument under section 2036(a)(1) as well. Consequently, we overrule petitioner's objection to the admission of the transcript of decedent's testimony.⁷

Section 2036(a) reflects a "legislative policy of subjecting to tax all property which has been the subject of an incomplete inter vivos transfer." United States v. O'Malley, 383 U.S. 627, 631 (1966). As stated in Commissioner v. Estate of Church, 335 U.S. 632, 645 (1949):

[A]n estate tax cannot be avoided by any trust transfer except by a bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property. After such a transfer has been made, the settlor must be left with no present title in the property, no possible reversionary interest in that title, and no right to possess or to enjoy the property then or thereafter. * * *

Section 2036(a)(1) provides for inclusion in the gross estate of all property transferred by decedent, "by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death * * *(1) the possession or enjoyment of, or the right to the income from, the property * * *."

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We note that petitioner objected to the introduction of the transcript of the decedent's testimony solely on the grounds that such evidence was offered in support of an issue that was not raised in the pleadings by respondent.

It is well settled that section 2036(a)(1) deals with two alternative notions: retention of "possession or enjoyment" and retention of the "right to income." McNichol's Estate v. Commissioner, 265 F.2d 667 (3d Cir. 1959), affg. 29 T.C. 1179 (1958). The "right to income" language was added to section 2036(a)(1) to apply in those circumstances in which the decedent was entitled to the income from the transferred property even though he does not in fact receive it. H. Rept. No. 708, 72d, Cong., 1st Sess. (1932), 1939-1 C.B. (Part 2) 457, 490-491; S. Rept. No. 665, 72d Cong., 1st Sess. (1932), 1939-1 C.B. (Part 2) 496, 532.

Petitioner argues that the trust documents do not, on their face, reserve to the decedent any power over the trust assets other than the power, as trustee, to invest the trust assets. This assertion, however, ignores the decedent's actual control over these trusts outside the confines of the trust instruments. The decedent's possession or enjoyment of the trust assets for purposes of section 2036(a)(1) need not be pursuant to a right specifically retained in the trust document. Skinner's Estate v. United States, 316 F.2d 517 (3d Cir. 1963). Moreover, the interest retained need not be one that is legally enforceable by the decedent. Estate of Kerdolff v. Commissioner, 57 T.C. 643 (1972); Estate of Barlow v. Commissioner, 55 T.C. 666 (1971).

In Estate of McCabe v. United States, 475 F.2d 1142 (Ct. Cl. 1973), the decedent transferred property to a trust that provided for the trust income to be paid to his wife for life with the remainder to his children. The trust was intended to be irrevocable and decedent did not, by the terms of the trust document, retain an interest that would cause section 2036 to be applicable. However, the evidence indicated that the decedent's wife never received any trust income and that the trustee, in fact, distributed income and corpus at decedent's direction primarily for decedent's own personal benefit. In addition, the beneficiaries had only a very nebulous awareness of the trust and its terms.

According to the Court of Claims, although the decedent did not, by the terms of the instrument of transfer, expressly retain a life interest, "[a] retention of the 'possession or enjoyment of, or the right to the income from, the property' may be inferred from the circumstances attendant upon the transfer and the manner in which the transferred property is used." Estate of McCabe v. United States, supra at 1147 (citations omitted). See Skinner's Estate v. United States, supra; McNichol's Estate v. Commissioner, supra; Estate of Hendry v. Commissioner, 62 T.C. 861, 872 (1974); Estate of Kerdolff v. Commissioner, supra.

Petitioner cites United States v. Byrum, 408 U.S. 125 (1972), in support of its assertion that the trust assets are not included in the gross estate pursuant to section 2036(a)(1). The

facts in Byrum, however, are clearly distinguishable from those in the instant case. Mr. Byrum created an inter vivos trust to which he transferred shares of stock in three closely-held corporations. Prior to the transfers, he owned 71 percent of the outstanding stock of each of these corporations. The beneficiaries of the trust consisted of Mr. Byrum's children. The trust agreement designated an independent corporation as sole trustee with extensive powers with regard to the control and management of the trust property. The trustee had sole discretion to exercise these broad powers subject, inter alia, to the settlor's retained right to vote the shares of stock held by the trust estate.

The Supreme Court held in Byrum that the rights reserved by the decedent with respect to the transferred stock did not constitute a retained enjoyment thereof. The Supreme Court emphasized that Mr. Byrum's de facto control over the trust income was effectively neutralized by the legal and practical restraints placed upon him. As a member of the board of directors of each corporation, Mr. Byrum was vested with broad discretion in determining "whether, when, and what amount" of dividends would be paid. United States v. Byrum, supra at 143. As a board member, however, Mr. Byrum was bound by fiduciary duties to act in a manner that was in harmony with the best interests of the corporations and their shareholders. A breach of these fiduciary duties would have subjected Mr. Byrum to a

shareholders' derivative lawsuit. Additionally, minority shareholders had a cause of action under State law if Mr. Byrum abused his fiduciary duties as a majority shareholder. These duties so modified the rights retained by the decedent that, according to the Supreme Court, the retained rights were insufficient to cause inclusion of the stock in his gross estate under section 2036(a).

The facts in Byrum contrast sharply with those in this case. Specifically, there were no fiduciary restraints on Mr. Wedum's possession of the trust assets after his resignation as trustee, whereas in Byrum there was an independent corporate trustee who ultimately controlled the flow of income to the trust beneficiaries. In addition, the independent corporate trustee in Byrum was a minority shareholder who had both the right and duty to hold Mr. Byrum responsible for any wrongful or negligent act as a controlling shareholder or as a director of those corporations. Furthermore, the Government's argument in Byrum focused upon the decedent's retention of voting rights in the stock transferred (and the resulting corporate control associated therewith), and not the actual stock (property) itself. In the present case there is a genuine issue of material fact as to whether decedent retained possession or enjoyment of the very property transferred (i.e., cash, bonds, etc.), thereby invoking the applicability of section 2036(a)(1). "The statutory language [of section 2036(a)(1)] plainly contemplates retention of an

attribute of the property transferred--such as a right to income, use of the property itself, or a power of appointment with respect either to income or principal." United States v. Byrum, supra at 149. (Fn. ref. omitted; emphasis added.)

Here the decedent established six inter vivos trusts for the benefit of various family members. The trusts were by their terms irrevocable, and no beneficial interest was specifically retained by him. There is, however, evidence to suggest that the assets associated with all six trusts were continuously retained by decedent in his own personal account over which he had sole signatory authority. He testified as follows in Federal District Court that he commingled the trust assets with his own personal and business assets:

Q. Before we examine this document, its true, isn't it that the trust did not have an account of its own, a bank account?

A. No.

Q. It was in that Home Account is that right? * * *

A. Yes.

Q. Your own account?

A. Yes.

Q. In which all monies for all enterprises went, is that not right?

A. Yes. [Trial transcript, supra at pp. 123-124.]

When these six trusts were initially established, decedent's continued possession of these assets was arguably in harmony with his role as trustee. Following his formal resignation, however,

respondent alleges that no assets were ever transferred to the successor trustee, John A. Wedum, and instead these trust funds remained in the decedent's exclusive possession and control.

In our judgment, there exists a genuine issue of material fact regarding whether decedent retained "possession or enjoyment" of the trust assets. As noted above, a retention of the possession or enjoyment of the property may be inferred from the circumstances surrounding the transfer and the way in which the transferred property is used. Estate of McCabe v. United States, 475 F.2d 1142, 1147 (Ct. Cl. 1973).

The decedent's mere retention of these trust assets in his personal bank account commingled with his personal funds creates a strong inference that his possession was a beneficial one. This is especially true in the context of intra-family trusts similar to the ones that exist in this case. Decedent presumably could have borrowed from these trust funds, or used the trust assets as collateral to obtain loans from other sources. In any event, his net worth was notably increased by virtue of the fact that these trust funds remained in his personal account. There is no evidence to indicate that any person, other than decedent, had authority to withdraw trust funds from this account. The decedent's admitted retention of these assets placed these funds effectively beyond the reach and control of the trustee named in the trust instruments. Thus, the focus at trial should be on the question of whether decedent continued, following the transfers,

to treat the trust assets as his own, to use the assets for business or personal purposes, and to retain generally the possession, enjoyment, and income therefrom.

We think there is also a genuine issue of material fact as to whether an informal agreement existed between the decedent-settlor and the decedent's successor-trustee (and co-trustee in the case of the John A. Wedum and Carola Palm Trusts), whereby decedent was to retain "possession or enjoyment" of the trust assets. The existence of such an agreement or understanding would be sufficient to cause the value of the property to be included in decedent's gross estate under section 2036(a)(1). Estate of Paxton v. Commissioner, 86 T.C. ____ (April 28, 1986); Skinner's Estate v. United States, 316 F.2d 517 (3d Cir. 1963); McNichol's Estate v. Commissioner, 265 F.2d 667 (3d Cir. 1959), affg. 29 T.C. 1179 (1958); Estate of McCabe v. United States, supra.⁸ The determination, at trial, of whether such an implied understanding existed between the parties requires a

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We express no view with regard to whether a genuine issue of material fact exists concerning the inclusion of the trust assets in decedent's gross estate pursuant to secs. 2036(a)(2), 2033 and 2038 as alternatively alleged by respondent.

consideration of all the facts and circumstances surrounding both the alleged transfers and the subsequent use of the trust assets. Estate of Paxton v. Commissioner, supra. Estate of Rapelje v. Commissioner, 73 T.C. 82, 86 (1979).⁹

Accordingly, on this record, we hold that petitioner has failed to carry its burden of showing that there is no genuine issue as to any material fact and, therefore, it is not entitled to judgment as a matter of law.¹⁰ Petitioner's motion for partial summary judgment will be denied.

An appropriate order
will be entered.

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Sec. 20.2036-1(a), Estate Tax Regs., provides in pertinent part as follows:

An interest or right is treated as having been retained or reserved if at the time of the transfer there was an understanding, express or implied, that the interest or right would later be conferred.

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Respondent objected to the admission into evidence of the estate tax examination report prepared by the Internal Revenue Service for the Estate of Maynard C. Wedum. The report was offered by petitioner in support of its assertion that sec. 2036 constitutes the sole issue framed by respondent's notice of deficiency. Because we find there to be a genuine issue of material fact with regard to the inclusion of the trust assets under sec. 2036(a)(1), we find it unnecessary to address respondent's objection to the admissibility of the examiner's report.

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T. C. Memo. 1986-248

UNITED STATES TAX COURT

WILLIAM E. DAVIES, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 19873-84.

Filed June 18, 1986.

William E. Davies, pro se.

Allan E. Lang, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

HAMBLEN, Judge: Respondent determined an income tax deficiency in the amount of \$862.48 and an addition to tax under section 6651(a)(1)¹ in the amount of \$53.47 for the taxable year

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All section references are to the Internal Revenue Code of 1954, as amended, during the year in issue unless otherwise indicated. All rule references are to the Tax Court Rules of Practice and Procedure unless otherwise indicated.

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1980. After concessions,² the issues for decision are (1) whether petitioner is entitled to travel and entertainment expenses in excess of those determined by respondent and (2) whether petitioner is entitled to a business automobile loss in excess of \$1,021.68.

FINDINGS OF FACT

Petitioner resided in Aurora, Colorado when the petition herein was filed. Petitioner has conceded that his 1980 Federal income tax return was untimely filed on May 7, 1981. Some of the facts have been stipulated and are so found. The stipulation of facts and exhibits attached thereto are incorporated herein by this reference.

During the year 1980, petitioner was self-employed as a sales representative for Northstar Pipe & Supply, Minnetonka, Minnesota ("Northstar") and GPA Products, Arvada, Colorado ("GPA"). Petitioner was not reimbursed for costs incurred as a sales representative of Northstar or GPA. Petitioner claimed automobile expenses of \$5,460.00 on Schedule C of his 1980 Federal income tax return. Using the alternative standard mileage rate as applied to total business miles of 29,640 miles, respondent in his notice of deficiency allowed automobile

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Petitioner concedes respondent's determination that \$89.00 of unreported income from Chuck's Contract Labor was earned during 1980. Petitioner also concedes liability concerning the addition to tax under section 6651(a)(1).

expenses in the amount of \$4,610.00.³ Petitioner claimed travel and entertainment expenses of \$2,754.00 on Schedule C of his 1980 Federal income tax return. In his statutory notice of deficiency, respondent has allowed travel and entertainment expenses as follows:

Lodging per receipts	\$131.00
Entertainment per log book	157.00
Meals for 60 days at \$14.00 per day	840.00
	<u>\$1,128.00</u>

In the pursuit of his trade, petitioner maintained a log book to record expenses relating to travel, lodging, and meals. Petitioner admitted that such log was not completely accurate. In our view the log book was both incomplete and inaccurate. At trial, petitioner submitted additional gasoline receipts, however, we were unable to locate appropriate entries and corresponding dates⁴ in the log book to reflect such expenses.

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At trial, petitioner conceded that respondent's disallowance of the additional \$850.00 of automobile expenses was appropriate. On brief, however, petitioner attempts to retract his concession and reasserts that \$850.00 of automobile expenses are allowable under section 162 and further asserts, apparently in the alternative, that some portion of such costs constitute adjustments to basis under section 1016 which thereby increase the automobile loss. We deem petitioner's concession at trial dispositive of the automobile expense issue, however, we note further that petitioner offered no proof as to such expenses and has totally failed to satisfy the burden of proof necessary to establish that such costs are either expensable or capital in character. Welch v. Helvering, 290 U.S. 111, 115 (1933). Rule 142(a).

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We note that the standard mileage yields a more favorable deduction.

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Petitioner maintains that his records were inadvertently removed from his home by his son during a move to Florida. Petitioner was able to secure the log book from his son in Florida; however, his belief is that the remaining corroborative evidence was lost in conjunction with his son's move. Other than the aforementioned additional gasoline receipts and a receipt for tires, petitioner was unable to produce receipts for the asserted deductions. Petitioner relied solely on his self serving testimony and the log book to establish entitlement to the asserted expenses.

Petitioner also claimed the amount of \$965.00 as a business loss on the disposition of a Saab automobile. In his notice of deficiency, respondent determined petitioner's allowable loss to be \$396.00. Petitioner subsequently located the bill of sale which established the cost basis of the Saab to be \$1,032.23. Respondent concedes that petitioner's allowable loss on the disposition of the Saab is \$1,021.68 computed as follows:

Saab basis	\$1,397.23
(cost \$1,032.23 plus improvements \$365)	
Less Sales Proceeds on Disposition	35.00
	<u>1,362.23</u>
Less Personal Use portion 25 percent	340.55
	<u><u>1,021.68</u></u>

Petitioner, on brief, asserts that certain costs concerning repairs to the Saab automobile in the amount of \$782.30 constitute additional expensable items or adjustments to basis under section 1016, but petitioner did not specifically

identify or allocate any such costs either at trial or on brief.⁵ Further, petitioner was unable to produce any receipts for these purported costs as corroborative evidence. A discrepancy exists in petitioner's testimony and the log book as to when such costs were incurred, although they were incurred, if at all, between July and October of 1980. The Saab automobile became inoperable on November 4, 1980 while petitioner was in Oklahoma during a business trip. Petitioner disposed of the Saab automobile at that time and purchased a Ford Pinto. Additionally, while serving GPA, petitioner leased a truck for three months.

OPINION

At the outset, we note that respondent's determinations are presumptively correct and the burden of proof rests with petitioner. Welch v. Helvering, 290 U.S. 111, 115 (1933); Rule 142(a). In general, section 162(a) allows a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 274(d) provides that no deduction shall be allowed under section 162 for any traveling expense, including meals and lodging while away

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The additional costs are:

Parts	\$456.97
Tools	104.33
Machine Shop	171.00
Towing	50.00
	<u>\$782.30</u>

Petitioner conceded the automobile expense issue at trial. Therefore we will view petitioner's assertions in the adjustment to basis context.

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from home, unless the taxpayer substantiates certain matters by adequate books and records or by sufficient evidence corroborating his own statement. Sec. 1.274-5(c)(2), Income Tax Regs., states that the "adequate records" requirement is satisfied by maintaining an account book, diary, statement of expense, or similar record and documentary evidence which, in combination, are sufficient to establish each element of the expense set forth in section 274(d).⁶ If the taxpayer lacks adequate records, a detailed written or oral statement and sufficient other corroborative evidence is required.

Sanford v. Commissioner, 50 T.C. 823, 828 (1968), affd. 412 F.2d 201 (2d Cir. 1969); Sec. 1.274-5(c)(3), Income Tax Regs. As to lost records, section 1.274-5(c)(5), Income Tax Regs., provides that:

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Sec. 274. Disallowance of Certain Entertainment, Etc., Expenses.

(d) Substantiation Required.-No deduction shall be allowed -

(1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home)

* * *

unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement (A) the amount of such expense or other items, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations.

Where the taxpayer establishes that the failure to produce adequate records through circumstances beyond the taxpayer's control, such as destruction by fire, flood, earthquake, or other casualty, the taxpayer shall have a right to substantiate a deduction by reasonable reconstruction of his expenditures.

Section 274(d) was enacted in part with the specific intent to overrule Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930), under which Courts held that deductions may be allowed in the absence of specific documentation where it appeared that taxpayers had paid or incurred deductible expenses. See Sanford v. Commissioner, supra.⁷

Petitioner claimed travel and entertainment expenses in the amount of \$2,754.00 on his 1980 tax return. Respondent has determined that petitioner's allowable travel and entertainment expenses were \$1,128.00. Respondent disallowed the balance of such deductions under section 274(d). We sustain respondent's disallowance. Petitioner has not satisfied the requirements of section 274(d). Petitioner produced a log book and several gasoline receipts. An examination of petitioner's log book reveals gaps which tend to produce more questions than answers. The gasoline receipts did not correspond to entries in the log book as indicated by date of purchase or amount purchased. Petitioner's log book failed to satisfy the adequate records requirement as sufficient evidence which corroborates petitioner's own statement. Petitioner's testimony was self serving and uncorroborated. Petitioner asserts that the

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See also Reinert v. Commissioner, T.C. Memo. 1979-512.

exception to section 274(d) should apply because the records were apparently lost when petitioner's son moved to Florida. Sec. 1.274-5(c)(5), Income Tax Regs. However, there is nothing in the record, other than petitioner's self serving statements, confirming that petitioner ever maintained any records other than those produced at trial. Further, petitioner does not qualify under the exception which allows reasonable reconstruction where the taxpayer establishes that the records were lost due to circumstances beyond his control, such as destruction by fire, flood, earthquake, or other casualty. The facts here are not those contemplated by section 1.274-5(c)(5), Income Tax Regs., as petitioner's lost records are not due to fire, flood, earthquake, or other casualty. Furthermore, we note that petitioner has not provided reasonable reconstruction of such expenses. Gizzi v. Commissioner, 65 T.C. 342 (1975).

We now address the loss on the disposition of petitioner's automobile. On his 1980 tax return, petitioner claimed a loss on the disposition of the automobile in the amount of \$965.00. In his notice of deficiency, respondent determined petitioner's allowable loss to be \$396.00. Upon presentation of the bill of sale, respondent concedes that petitioner's allowable loss is \$1,021.68. Respondent has allowed an adjustment to basis under section 1016 in the amount of \$365.00. Petitioner contends that \$456.97 for parts, \$104.33 for Saab tools, \$50.00 towing cost, and \$171.00 machine shop services are adjustments to basis under section 1016 which increase the amount of loss under sections

165(a) and (c)(1). As to this contention, petitioner must also satisfy his burden of proof. Welch v. Helvering, supra; Rule 142(a).

Petitioner produced no receipts to establish the asserted costs incurred, although petitioner's log book entry on September 4, 1980 does indicate that petitioner incurred such costs, except towing which occurred in November 1980. Respondent has allowed petitioner improvements as adjustments to basis under section 1016 in the amount of \$365.00. The inexactitude herein was of petitioner's own making and that fact must weigh heavily against him. Cohan, supra. We determine that respondent's allowance appropriately and adequately reflects petitioner's adjustments to basis of the Saab. Petitioner has failed to satisfy his burden of proof. Therefore, petitioner's allowable loss on the disposition of the Saab is \$1,021.68 as conceded by respondent.

To reflect the foregoing,

Decision will be entered
under Rule 155.

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T. C. Memo. 1986-249

ORIGINAL

UNITED STATES TAX COURT

W.B. LASHER COMPANY DBA
WES LASHER VOLKSWAGEN, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

WES LASHER PORSCHE-AUDI, INC., Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 21863-80, 21864-80. Filed June 18, 1986.

Mark S. Sewell, for the petitioner.

Beatrice M. Pearson, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

HAMBLEEN, Judge: Respondent determined deficiencies in petitioners' Federal income tax and determined additions to tax under section 6653(a)¹ as follows:

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Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and all Rule references are to the Tax Court Rules of Practice and Procedure.

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W.B. Lasher Company dba Wes Lasher Volkswagen ("Lasher VW")

	<u>Deficiency</u>	<u>Addition</u>
1975	\$79,498.00	\$3,975.00
1976	26,182.00	1,309.00

Wes Lasher Porsche-Audi, Inc.
aka Lasher Porsche-Audi, Inc. ("Lasher Porsche-Audi")

	<u>Deficiency</u>	<u>Addition</u>
1975	\$33,684.00	\$1,684.00
1976	9,856.00	493.00

After concessions² the sole issue for determination is whether Lasher VW and Lasher Porsche-Audi are entitled to claimed rental expense deductions under section 162(a)(3) concerning payments with respect to sale and leaseback transactions with the Lasher Family Trust.

The stipulated findings of fact and accompanying exhibits are incorporated herein by this reference as is the post-trial partial stipulation of settlement.

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The parties have resolved the following issues by stipulation of fact and stipulation of partial settlement: (1) petitioners concede that respondent's disallowance of certain professional fees incurred during the years 1975 and 1976 was appropriate; (2) respondent concedes that petitioners are not liable for additions to tax under section 6653(a) for each of the years in issue; (3) Lasher VW concedes that respondent's disallowance of investment tax credit for the year 1976 was appropriate; (4) the parties agree that Lasher Porsche-Audi is entitled to an investment tax credit in the amount of \$1,533.00 for the taxable year 1976 and that respondent's disallowance of the balance of the investment tax credit claimed for such year was proper; (5) petitioners concede that respondent's disallowance of certain "labor contract" expenses deducted with respect to service agreements with Lasher Service Corporation during the taxable years 1975 and 1976 was appropriate; (6) Lasher VW concedes that respondent's disallowance of certain "management contract" expenses deducted for the taxable years 1975 and 1976 was appropriate.

FINDINGS OF FACT

Petitioners, Lasher VW and Lasher Porsche-Audi, each maintained a principal place of business at Sacramento, California, when the petitions herein were filed. Wesley B. Lasher ("Wes") and Inez Lasher ("Inez") owned as community property all of the issued and outstanding stock of Lasher VW and Lasher Porsche-Audi during all relevant periods to these cases until December 30, 1975.

Wesley B. Lasher Investment Corporation ("Lasher Investment") was incorporated on December 31, 1975, at which time it issued all of its outstanding class A voting common stock to Wes.³ Lasher Investment acquired the entire stock interest of Lasher VW and Lasher Porsche-Audi on December 30, 1975.

Lasher VW was incorporated during the year 1956. Lasher Porsche-Audi was incorporated during the year 1973. During the years at issue, petitioners were engaged in business as retail automobile dealerships under agreements with Volkswagen of America, Inc. and the Porsche-Audi Division of Volkswagen of America, Inc. Prior to the year 1956, Wes had been employed with a paper company as a sales manager with geographic responsibility

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Lasher Investment also was authorized to issue Class B nonvoting preferred stock par value \$50.00 per share with an annual dividend privilege equal to three percent of par value and Class C nonvoting common stock par value \$10.00 without dividend privileges. At various times during the years at issue, Wes owned differing interests in the Class B and the Class C stock of Lasher Investment. On December 27, 1976, Lasher Investment cancelled Wes' 1000 shares of the Class C stock and issued 500 shares to each of Wes' sons Mark W. Lasher and Scott Ryan Lasher.

for the Western United States. Wes left the paper company to avoid a relocation to the Mid-West. At that time, Wes joined a company which sold or leased heavy operating equipment such as trucks, tractors, and earth graders. Wes had entered the heavy equipment business with a view to secure an automobile dealership franchise. Wes considered franchise opportunities with General Motors' Buick and Cadillac Divisions, but ultimately entered into a franchise agreement with Volkswagen of America, Inc. during the year 1955.

Lasher VW and Lasher Porsche-Audi are accrual basis, calendar year taxpayers. During the relevant periods to the determinations herein, petitioners elected the following individuals to serve as officers:

Lasher VW

Wes, President and Treasurer
Robert B. Suber ("Suber"), Vice President
Gilbert Hetzel ("Hetzel"), Vice President
Charles B. Beveal, Vice President
Lilo Maskow, ("Maskow"), Secretary and Assistant Treasurer
Shirley A. Thrasher ("Trasher"), Assistant Secretary

Lasher Porsche-Audi

Wes, President and Treasurer
Inez, Vice President
Thrasher, Secretary
Maskow, Assistant Secretary

Petitioners also elected Wes, Inez, and Maskow to serve as directors during all relevant periods herein.

Respondent's determinations within the notices of deficiency arise from a series of transactions developed by financial planners Harold B. DeJulio ("DeJulio") and George G. Nicoladze

("Nicoladze"). DeJulio and Nicoladze were recommended to Wes by another local automobile dealer who operated several franchises. Wes desired to accomplish certain financial objectives. One such objective was to consolidate the personnel of Lasher VW and Lasher Porsche-Audi to avoid duplicative administrative burdens, such as payroll and job assignment, which are typically associated with multiple employers. Wes also desired to improve employee benefit plans and to discuss the feasibility of employee stock ownership plans to compensate and provide incentive to certain employees who had served petitioners for many years. Wes was not certain whether his sons Mark B. Lasher ("Mark") and Scott Ryan Lasher ("Scott") would participate in the automobile dealerships. However, Wes wanted to insure that compensatory incentives and the opportunity for his sons to develop the business skills necessary to operate the dealerships were available in the event they entered into the business. Lastly, Wes sought recommendations concerning general tax planning and personal financial counseling, including estate planning considerations. After consultations, Wes employed DeJulio and Nicoladze in November of 1975 to develop a financial strategy to effectuate the aforementioned objectives.

In December of 1975, Wes implemented the recommendations of DeJulio and Nicoladze. Such recommendations entailed the creation of three new entities: (1) Lasher Investment, (2) the Lasher Service Corporation ("Lasher Service"), and the Lasher Family Trust ("Lasher Trust").

Lasher Investment was incorporated specifically to manage and control the investments of Wes. Lasher Investment issued all of its outstanding Class A voting common stock to Wes. Lasher Investment entered into a service employment arrangement with Wes on February 2, 1976. Lasher VW agreed to pay Lasher Investment an annual management fee for the services of Wes.⁴ Lasher Investment adopted a fiscal year ending January 31.

Lasher Service was incorporated on December 2, 1975. The original shareholders of Lasher Service were Suber, Hetzel, and Maskow, each of whom had been dedicated and loyal employees of Lasher VW for several years. During the years at issue, each also served as elected officers of Lasher VW. During 1975, Thrasher also became a record shareholder of Lasher Service. Thrasher was an officer of petitioners throughout the period at issue. The employees of Lasher VW and Lasher Porsche-Audi, including sales personnel, mechanics, and administrative employees, became employed by Lasher Service. Petitioners' employee benefit plans were transferred to new plans administered on behalf of the employees of Lasher Service. The existing union agreements negotiated on behalf of petitioners' employees were to remain effective as to Lasher Service. Lasher Service and

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Respondent in his statutory notice of deficiency disallowed the management fee deducted by Lasher VW in the amount of \$18,000 with respect to its 1975 tax return and disallowed the "management contract - net" expense in the amount of \$10,350 deducted on its 1976 return. Lasher VW has conceded the appropriateness of respondent's determination. See note 2, supra.

petitioners negotiated "service agreements" such that Lasher Service agreed to "provide at its expense all the personnel that in its judgment may be needed to provide sales, administrative, clerical, and maintenance" services required by petitioners. Lasher Service adopted a fiscal year ending November 30. The "Service Agreements" provided that petitioners would pay Lasher Service for its employee services on a quarterly basis as of March 1, June 1, September 1, December 1 of each year and that such amount would be due on the first day of each quarter. Lasher Service adopted a fiscal year ending November 30.⁵

The Lasher Trust was created on October 1, 1975, as an integral function of the overall financial plan designed by DeJulio and Nicoladze. The Lasher Trust was funded in the amount of \$100.00 by George A. Lasher as Trustor. George A. Lasher is the father of Wes. The Lasher Trust designated Mark as Trustee. The beneficiaries of the Lasher Trust are Mark and Scott, the grandchildren of George A. Lasher and "any other grandchildren born or adopted". Scott has no knowledge of the assets or cash flow of the Lasher Trust, and the Lasher Trust has not provided him with any accounting. The Lasher Trust is a cash basis taxpayer utilizing a fiscal year ending of February 28.

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In his notices of deficiency, respondent disallowed amounts accrued by petitioners as of the quarter beginning December 1, 1975, and December 1, 1976, as provided under the "Service Agreement." Petitioners concede the appropriateness of respondent's determination. See note 2, supra.

The Lasher Trust provides Mark, as Trustee, the "right, power, and sole discretion to employ a manager for the management, protection, control, sale or other disposition" of the Trust "estate and property and all the assets thereof, or for any parts thereof." The Lasher Trust contains no limitation as to who Mark could employ as such manager. The Lasher Trust is irrevocable. However, it provided George A. Lasher, as Trustor, the power to dismiss the Trustee and appoint "any person other than himself and the father of the beneficiaries" to act as Trustee and further provided the Trustor the right to assign such power to any person "who in his opinion may qualify as competent appointers." The Lasher Trust also provided that the Trustee may apply income and principal, up to the entire amount of the corpus, for care, support, and maintenance, including reasonable luxuries for the benefit of Inez, the beneficiaries' mother, during her widowhood.

On March 5, 1976, Lasher VW executed a Bill of Sale with the Lasher Trust whereby the Lasher Trust agreed to purchase for the amount of \$105,814.00 certain equipment and furniture used by Lasher VW in the conduct of its business. Mark, as Trustee of the Lasher Trust, executed an unsecured promissory note payable to Lasher VW for the total purchase price of \$105,814.00 to be repaid over a ten year period in equal annual payments with interest at four percent per annum on the unpaid balance. In a simultaneous transaction, Lasher VW agreed to leaseback such property until February 28, 1981, a period of four years, and the

lease agreement provided for a monthly lease payment during the term of agreement in the amount of \$2,645.00. The lease agreement further provided Lasher VW an option to extend such lease for an additional period of five years ending February 28, 1986. The renewal option provided that the monthly rental payment was to be two and a half percent of the listed value of such assets as provided within the appendix attached to the Bill of Sale.

Also on March 5, 1976, Lasher Porsche-Audi executed a Bill of Sale with similar provisions in the amount of \$40,662.00 to Mark, as Trustee, of the Lasher Trust conveying to the Trust the equipment and furnishings used to conduct its business. Mark, as Trustee, executed an unsecured promissory note for the full purchase price of such sale. The note provided for ten annual equal payments or principal with interest at four percent per annum on the unpaid balance. Under terms similar to that of Lasher VW, Lasher Porsche-Audi agreed to leaseback the subject equipment and furniture for a period of five years. Lease payments were due monthly in the amount of \$1,016.55. The lease agreement provided an option to extend for an additional period of five years until February 28, 1981. The lease agreement further provided that the monthly payment be calculated as two and a half percent of the listed value of such assets as identified and valued within the appendix attached to the agreement.

Wes arranged to have petitioners' equipment and furnishings subject to the foregoing sale and leaseback transactions appraised prior to their sale. The furnishings were appraised by a representative of Western Contract Furnitures, a large, regional supplier of office furniture. The automobile service equipment was also appraised by a regional supplier of such items. The basis of appraised value was "current replacement costs".

The appraised values of the subject assets were attached to each Bill of Sale and lease agreement executed between each petitioner and the Lasher Trust. The appraised value of the Lasher VW assets and the Lasher Porsche-Audi assets were the same as the purchase price agreed to by the Lasher Trust, \$105,814.00 and \$40,662.00 respectively. None of the individuals who appraised the subject assets testified at trial. Petitioners each reported the gain which resulted from such transactions.⁶

At trial, Michael A. Mecey ("Mecey") testified on behalf of petitioners concerning the appropriateness of the monthly two and one half percent lease fee. Mecey had prior employment experience calculating lease rates within the health care equipment industry. Mecey did not view the subject assets or examine the inventories of such assets. Mecey testified that the reasonable rate on a ten year lease of equipment during the years

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Because respondent has denied sale treatment to the transactions at issue, the statutory notices of deficiency reflect the reversal of such gain reported.

at issue would have been 1.675 percent per month. Petitioners, on brief, concede that the rental rate of two and one half percent per month was not reasonable and assert that Mecey's opinion be adopted. Mecey's analysis assumed a fair market value of the subject assets to be \$150,000. Mecey testified that as an industry practice, lease payments are payable in advance of each month.

The agreed lease rate of two and one half per month was suggested by DeJulio and Nicoladze. Wes, as petitioners' representative, and Mark, as Trustee of the Lasher Trust, adopted these terms without modification or negotiation. Maskow, a shareholder-employee of Lasher Service, performed all bookkeeping services for the Lasher Trust. Maskow was instructed by Alex F. Klimen, C.P.A. ("Klimen"), as to the necessary accounting journal entries. Klimen had been employed as an accountant to petitioners, Lasher Service, Lasher Investment and Lasher Trust until his death in August of 1978.

The Lasher Trust opened a checking account ("Trust Account") on December 23, 1975. The Trust Account was held by Wes and Mark as joint tenants with right of survivorship, each of whom was authorized signatories. Wes had personally opened the Trust Account, and Mark did not accompany Wes to open such account. The Trust Account was a noninterest bearing investment and remained the sole such account until April 15, 1982.

The administration of the Trust Account was not performed according to the Lasher Trust instrument. Although the Trust Account appointed Wes as a joint survivor with signatory authority, the Lasher Trust instrument provided Wes with no such powers. During the years 1976 through 1979, Wes signed 81 of the 138 checks drawn on the Trust Account, including Lasher Trust payments of principal and interest concerning the Lasher Trust notes payable to petitioners.⁷ The Lasher Trust issued 25 checks in the total amount of \$3,500.00 to Scott during the years 1977 through 1979 while Scott attended college. Wes signed 23 such checks. Wes testified that he routinely signed all checks on Maskow's desk. During the year 1977, the Lasher Trust acquired life insurance policies with respect to Wes and Inez. The dollar amount of the Trust Account checks signed by Wes in his sole capacity was \$106,297.30.

The Lasher Trust was authorized to purchase new equipment for lease to petitioners. Hetzel, the experienced service manager and employee-shareholder of Lasher Service, recommended to Mark, as Trustee, the need to acquire new automobile service equipment for use by petitioners. Maskow recommended the

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<u>Trust Account checks drawn</u>				
<u>Year</u>	<u>Mark</u>	<u>Wes</u>	<u>Total</u>	<u>% Signed by Wes</u>
1976	6	2	8	25%
1977	7	37	44	84%
1978	13	36	49	73%
1979	31	6	37	16%
	<u>57</u>	<u>81</u>	<u>138</u>	

acquisition of office equipment needed by petitioners. Mark valued the judgment of Hetzel and Maskow and generally followed their recommendations. The leases executed between Lasher Trust and petitioners contain no provision concerning the lease of new equipment purchases. The Lasher VW lease provides a fixed lease payment of \$2,645.00 per month during the approximate five year term. The Lasher Porsche-Audi lease contains a fixed lease payment of \$1,065.55 per month during the five year term. The renewal provision of each lease was specifically applicable to "only those items listed in Appendix A attached hereto as may still be in use" at end of such lease term. The rental payment of such items subject to renewal was to be two and one half percent of listed value. In practice, the Lasher Trust did not require monthly lease payments as specified within the lease agreements. Petitioners, in fact, paid the Lasher Trust an annual lease payment computed as of the Lasher Trust's fiscal year of February 28. Additionally, the Lasher Trust did not include new equipment acquisitions within its inventory until the beginning of its fiscal year subsequent to acquisition. The timing of petitioners' annual lease payment and the deferred inclusion of new acquisitions within inventory allowed petitioners to use new equipment at a deferred cost up to 23 months.

OPINION

The sole issue for determination is whether petitioners are entitled under section 162(a)(3) to deduct equipment rental payments as ordinary and necessary business expenses paid to the Lasher Trust pursuant to sale and leaseback transactions of petitioners' automobile service equipment and office furniture. The bulk of the transfer and leaseback cases have arisen in the area of intra-family transfers to trusts, either by sale or gift, followed by a leaseback to the transferor.⁸ The parties here concur that the principles established in May v. Commissioner, 76 T.C. 7 (1981), affd. 723 F.2d 1434 (9th Cir. 1984), govern our disposition of the issue herein. See Golsen v. Commissioner, 54 T.C. 742 (1970), affd. 445 F.2d 985 (10th Cir. 1971), cert. denied 404 U.S. 940 (1971).⁹ Petitioners assert that the

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Carroll v. Commissioner, T.C. Memo. 1978-173.

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In the gift and leaseback scenario, this Court and the Court of Appeals for the Ninth Circuit in May v. Commissioner, 76 T.C. 7 (1981), affd. 723 F.2d 1434 (9th Cir. 1984), rejected the view that the entire transaction must satisfy the business purpose doctrine. Such view requires that the gift transaction and the leaseback transaction viewed as a single transaction must be grounded in economic reality. See Matthews v. Commissioner, 61 T.C. 12 (1973), revd. 520 F.2d 323 (5th Cir. 1975), cert. denied 424 U.S. 967 (1976); Perry v. United States, 520 F.2d 235 (4th Cir. 1975), cert. denied 423 U.S. 1052 (1976); Van Zandt v. Commissioner, 341 F.2d 440 (5th Cir. 1965). In May, this Court and the Court of Appeals for the Ninth Circuit adopted a bifurcated analysis which initially determines the validity of the gift of property in trust and then examines the leaseback to determine whether a business purpose for such rentals exists. May v. Commissioner, 76 T.C. 7 (1981), affd. 723 F.2d 1434 (9th Cir. 1984); see also Rosenfeld v. Commissioner, 706 F.2d 1277 (2d Cir. 1983), affg. a Memorandum Opinion of this Court; Quinlivan (footnote continued)

requirements of May have been satisfied. Respondent asserts that petitioners have failed to satisfy the May requirements and that the sale of petitioners' subject assets was solely to avoid taxes and devoid of economic reality and business purpose. The resolution of the issue here, therefore, is one of fact that is to be determined by consideration of all the facts and circumstances surrounding the transactions before the Court.

The statutory basis to deduct rental expenses as ordinary and necessary business expenses is section 162(a)(3), which provides in pertinent part:

(a) In General.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including--

* * *

(3) rentals or other payments required to be made as a condition to the continued use or possession of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

In Matthews v. Commissioner, 61 T.C. 12 (1973), revd. 520 F.2d 323 (5th Cir. 1975), cert. denied 424 U.S. 967 (1976),¹⁰ and in May, this Court applied the following criteria to determine whether a rental expense deduction under section 162(a)(3) is allowed in the gift and leaseback scenario:

(footnote continued from previous page)
v. Commissioner, 599 F.2d 269 (8th Cir. 1979), cert. denied 444 U.S. 996 (1979); Brown v. Commissioner, 180 F.2d 926 (3d Cir. 1950) cert. denied 340 U.S. 814 (1950), Skemp v. Commissioner, 168 F.2d 598 (7th Cir. 1948).

¹⁰

See note 9, supra.

(1) The grantor must not retain substantially the same control over the property that he had before he made the gift;

(2) The leaseback should normally be in writing and must require payment of a reasonable rental;

(3) The leaseback (as distinguished from the gift) must have a bona fide business purpose; and

(4) The grantor must not possess a disqualifying "equity" in the property within the meaning of section 162(a)(3).

In May v. Commissioner, 76 T.C. at 13, we reiterated the four prong standard established in Matthews. The Court of Appeals for the Ninth Circuit, to which an appeal herein would lie, applied the following criteria established in Brooke v. United States, 468 F.2d 1155, 1157 (9th Cir. 1972), affg. 300 F. Supp. 465 (D. Mont. 1969), in affirming our opinion in May:

- (1) The duration of the transfer;
- (2) The controls retained by the donor;
- (3) The use of the gift property for the benefit of the donor; and
- (4) The independence of the trustee.

May v. Commissioner, 723 F.2d at 1436; Brooke v. United States, 468 F.2d at 1157.

In Brooke, the Court of Appeals for the Ninth Circuit stated that "[m]any decisions pivot on the issue of the independence of the trustee." Brooke v. Commissioner, supra at 1157. The necessary independence of the trustee in Brooke was achieved in a Montana guardianship where a taxpayer, who was an appointed

guardian for his children, transferred property to his children and without written lease, leased back such property at a reasonable rent. The Court of Appeals for the Ninth Circuit concluded in Brooke that a court appointed trustee - even if such person was the taxpayer - ensured trustee independence. Brooke v. Commissioner, supra at 1158. In May, the taxpayers deeded their interest in improved real estate to an irrevocable trust for the benefit of their children. The trust instrument appointed the taxpayer and a friend, Harlos Gross, as co-trustees. At the trial in May, Harlos Gross testified that he previously served as trustee for other trusts and was aware of the fiduciary nature of the position as well as the statutory liability imposed on trustees under California state law. May v. Commissioner, 76 T.C. at 14. The Court of Appeals for the Ninth Circuit was satisfied that trustee independence was established. May v. Commissioner, 723 F.2d at 1437.

Whether a trustee has acted as an independent trustee is a question of fact. Lerner v. Commissioner, 71 T.C. 290 (1978). In Lerner we considered the following criteria as persuasive in our determination: (1) the trustee had several appraisals to determine fair rental value; (2) the rent was rendered to the trustee when due; (3) the rent was adjusted to reflect any additional equipment so leased; (4) the trustee exercised prudent business judgment concerning acquisitions of new equipment and the use of borrowed funds; (5) and the trustee, an attorney, was aware of his fiduciary obligations. Lerner v. Commissioner,

supra at 302-303. Respondent asserts that facts in the instant case belie a determination that petitioners satisfy the May - Brooke standard.

We are persuaded that trustee independence is absent in the instant case. We are also persuaded that petitioners exercised substantial control of the administration and management of the Lasher Trust. The administration of the Trust Account, as provided within the Lasher Trust, was improper from the outset. Wes opened the Trust Account. Mark did not accompany Wes to open the Trust Account. Wes was accorded signatory authority concerning the Trust Account with a right of joint survivorship. The Lasher Trust provided Wes no such authority. During the years 1976 through 1979, Wes wrote 81 of the 138 checks negotiated by the Lasher Trust. Wes signed payments of principal and interest remitted by the Lasher Trust to petitioners during such period relative to the notes payable. Wes signed Trust Account checks in total amount of \$106,297.30. Maskow prepared all petitioners' checks for Wes' signature. Maskow also performed all bookkeeping services for Lasher Trust, although not compensated by Lasher Trust. Wes testified that his check writing activities concerning the Trust Account were accidental as all checks were prepared by Maskow, appear in similar color, and were apparently comingled with petitioners' checks. There is no evidence of insidious self dealing or wrongful application of Lasher Trust funds by Wes. Nonetheless, Wes simply was not a Trustee of the Lasher Trust. The frequent and substantial

actions of Wes concerning the Trust Account belie a determination of trustee independence, but instead, reflect that the Lasher Trust and its assets were dominated and controlled by Wes. Mark was an unassertive and inattentive trustee who manifested little comprehension of his fiduciary responsibilities. Cf. May v. Commissioner, 723 F.2d at 1437; Brooke v. Commissioner, 468 F.2d at 1157-1158. Mark's tacit assent to the check writing activities of Wes is particularly fatal to petitioners' assertions of trustee independence. We are certain that a cursory review of the Trust Account would have alerted Mark to Wes' check writing activities.

Further indicia of the absence of the May - Brooke criteria are evident concerning Mark's reliance upon Maskow. Maskow was an officer of petitioners, yet, she performed, without compensation, all bookkeeping services for the Lasher Trust. Maskow also performed bookkeeping services for petitioners. Maskow calculated rental payments due to Lasher Trust from petitioners. The lease agreements recited that such payments were due monthly, however, in practice, full payment was rendered at year end. Cf. Lerner v. Commissioner, supra at 302. The Lasher Trust notes payable to petitioners were due on an annual basis. Maskow paid petitioners' entire rental payment and the Lasher Trust note installment payment at the end of each year. Upon the instruction of Klimen, accountant to petitioners and the Lasher Trust, Maskow made advance payments on the Lasher Trust notes payable to petitioners so as to eliminate any excess Trust

Account cash. The Lasher Trust notes payable were written at a below market rate of interest at an annual rate of four percent. The Trust Account was a noninterest bearing account, however, "excess cash" was not permitted to accumulate due the instruction of Klimen and the actions of Maskow.

The accounting treatment for billing purposes concerning the new equipment acquisitions of the Lasher Trust indicates the absence of trustee independence and the significant control exercised by petitioners. The Lasher Trust inventory of assets subject to lease reflected new asset acquisitions at the fiscal year end of Lasher Trust subsequent to purchase. Mark relied upon the recommendations of Maskow and Hetzel concerning new equipment purchases of the Lasher Trust. Although Maskow and Hetzel were employee-shareholders of Lasher Service, Maskow was also an officer of petitioners' and Hetzel an officer of Lasher Porsche-Audi during the years at issue. Due to the adopted policy of annual payments, petitioners were able to use new equipment on a deferred payment basis. We can find no affirmative act of trustee independence during the years at issue. We find, instead, substantial facts indicating that petitioners exercised substantial control over the Lasher Trust. The inescapable conclusion is that the Lasher Trust was in fact administered by Maskow and Wes during the years in issue. The Court of Appeals for the Ninth Circuit has clearly established that trustee independence and the degree of control retained by the transferor are critical factors in transfer-leaseback

transactions. May v. Commissioner, 723 F.2d at 1437; Brooke v. United States, 468 F.2d at 1157. The absence of trustee independence and the significant degree of control exercised by petitioners concerning Lasher Trust assets negate a factual finding that true ownership of subject assets was transferred to the Lasher Trust. Mark, as Trustee, was dominated by Wes and petitioners. Mark was totally unattentive of and unassertive regarding his fiduciary delegations to such a degree that the Lasher Trust was in fact an alter ego of petitioners. The sale and leaseback of petitioners' assets is not, therefore, recognized for tax purposes. We conclude that respondent's disallowance of petitioners' rental expense payments to Lasher Trust was appropriate under the May - Brooke analysis.

Additional comments are pertinent to address respondent's assertion that the sale of petitioners' subject assets and subsequent leaseback was solely to avoid taxes and devoid of economic reality and business purpose. It is well settled that a transfer solely to avoid taxes will not be recognized for tax purposes. Gregory v. Helvering, 293 U.S. 465 (1935); Frank Lyon Co. v. United States, 435 U.S. 561 (1978), Karme v. Commissioner, 73 T.C. 1163 (1980), affd. 673 F.2d 1062 (9th Cir. 1982). For gift and leaseback transactions, this Court and the Court of Appeals for the Ninth Circuit in May adopted the bifurcated analysis established in our opinion in Matthews thereby rejecting the application of the business purpose test to the gift aspect

of the transfer.¹¹ The rationale of this approach is that the expression of donative intent via gift transfer is incompatible with the business purpose test. Commissioner v. Duberstein, 363 U.S. 278 (1960). In the sale and leaseback scenario, however, the entire transaction must be examined as an integrated transaction. Where no legitimate business purpose is served and the transaction is simply motivated by a desire to minimize taxes, the transfer and leaseback will be disregarded. W.H. Armston Co. v. Commissioner, 188 F.2d 531, 533 (5th Cir. 1951), affg. 12 T.C. 539 (1949). We emphasize that the business purpose must have substance and not be artificial. Shaffer Terminals, Inc. v. Commissioner, 16 T.C. 356, 364 (1951), affd. per curiam 194 F.2d 539 (9th Cir. 1952). We think that in the context of this case, petitioners continued need for the subject assets was so compelling that the sale and leaseback must be viewed as an integrated transaction which must satisfy the business purpose test.¹² It is also clear that the business purpose must further the profit objectives of petitioners as business entities and not the personal financial objectives of the shareholders. Southeastern Canteen Co. v. Commissioner, 410 F.2d 615 (6th Cir. 1969), affg. in part a Memorandum Opinion of this Court. We

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See note 9, supra.

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Carroll v. Commissioner, T.C. Memo. 1978-173.

agree with respondent that petitioners' sale and leaseback was devoid of economic reality and advanced no legitimate business purpose.

The Lasher Trust was an integral aspect of the overall financial plan developed by financial planners DeJulio and Nicoladze. The sale and subsequent leaseback of petitioners' automobile service equipment and office furnishings was contemplated from the outset. We must evaluate the transactions in correlation with the foregoing to determine whether the indicia of economic reality or business purpose are present. The degree of economic reality or business purpose that must be present in a transaction to be recognized for tax purposes is not capable of precise definition. The business purpose standard is determined from the pertinent facts and circumstances surrounding the transfers, particularly the valuation of the assets sold and the reasonableness of the agreed upon rent. Here, we arranged to have petitioners' equipment and office furnishings appraised by regional suppliers of such items. One appraisal of the automobile service equipment and one appraisal of the office furnishings was acquired. The Lasher Trust agreed to purchase petitioners' assets at these appraised values. No additional or comparable appraisals were sought. None of the individuals or concerns who performed the appraisals appeared at trial. The valuation basis of the appraisals was "current replacement costs."

In his statutory notices of deficiency, respondent has disregarded the sales for tax purposes but asserts on brief that the purchase price exceeded fair market value. Petitioners bear the burden of proof that respondent's determinations are not correct. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a). Because we have determined that the sale and leaseback transactions are to be disregarded for tax purposes under the May - Brooke analysis and the business purpose test, we need not embark on the inherently imprecise valuation exercise to determine the fair market value of the transferred assets. We believe, however, that the facts indicate an absence of arm's length negotiation and reflect instead self serving valuations. Peck v. Commissioner, 752 F.2d 469 (9th Cir. 1985), affg. a Memorandum Opinion of this Court. The appraisers, who were suppliers to petitioners, were not disinterested parties. Mark, as Trustee, merely accepted the appraised values determined by the suppliers and secured by Wes. Further, Mark, as Trustee, performed no independent analysis to determine whether the assets were valued at fair market. The agreed rent upon leaseback was determined by DeJulio and Nicoladze. Neither petitioners nor the Lasher Trust negotiated or modified the suggestions of DeJulio and Nicoladze. Petitioners on brief concede that the rent was not reasonable but assert that the rate determined by Mecey represents a reasonable rate. Mecey's analysis was flawed in that it assumed the fair market value of the transferred assets to be \$150,000, which merely approximates the total purchase

price of \$146,476. We reiterate that we need not determine a reasonable rent due to our conclusions herein. However, the existence of excessive rent, which we believe is evident here, indicates the absence of arm's-length negotiations and indicates the absence of business purpose.

Wes testified that he wanted to involve Mark in the business to develop Mark's business skills and so that Mark, as Trustee, could become familiar with the equipment used by petitioners. Such motivation is not attributed to petitioners and is insufficient to satisfy the requisite business purpose.

Southeastern Canteen Co. v. Commissioner, supra. Furthermore, in the sale and leaseback context, if the assets purchased are declining in value and the purchase price is inflated to generate basis, the purchase is illusory because the purchaser is building no equity in the assets. There is no indication in the record that petitioners' sale of assets improved its financial position with creditors or third parties.¹³ The only service was incidental to Wes' financial and estate plans. Lastly, we need not restate the factors of the May - Brooke analysis relative to the absence of trustee independence and the retention of significant control by petitioners in the business purpose context. However, we are of the view that such considerations

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Cf. Carroll v. Commissioner, T.C. Memo. 1978-173.

are indicative of the petitioners' failure to establish a legitimate business purpose evidenced by arm's-length transactions.

We have addressed the appropriate factors established by the Court of Appeals for the Ninth Circuit in May and Brooke as well as respondent's assertions relative to the business purpose test. In our view the sale and subsequent leaseback of petitioners' assets must be disregarded for tax purposes. We have considered petitioners' other arguments, which we find unpersuasive and contrary to the factual indications.

Due to concessions of the parties,

Decision will be entered
under Rule 155.



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Jul 11.7/2 : 1986-250

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T. C. Memo. 1986-250

UNITED STATES TAX COURT

GALO GOURDIN and SHERRY A. GOURDIN, Petitioners v. COMMISSIONER
OF INTERNAL REVENUE, Respondent

Docket No. 30463-83.

Filed June 19, 1986.

Galo Gourdin, pro se.

James S. Daubney, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WRIGHT, Judge: Respondent determined a deficiency in petitioners' 1981 Federal income tax of \$5,397. After concessions by the parties, the sole issue for decision is whether petitioner is entitled to deduct expenses in the amount

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of \$7,699 as employee business expenses under section 162(a)(2).¹

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and the exhibits attached thereto are incorporated herein by this reference.

Petitioners Galo and Sherry A. Gourdin² resided in Mission Viejo, California, when the petition herein was filed. They timely filed a joint income tax return for 1981.

From January 1 through January 28, 1981, petitioner was employed as a sales manager for Bartell Marine Electronics in Newport Beach, California. He commuted to his job from his home in Mission Viejo, California. On January 28, 1981, petitioner left his employment with Bartell Marine Electronics in order to accept a new position as sales manager of Campbell Management Corporation in San Diego, California.

Campbell Management Corporation was a going concern in 1981. At the time petitioner accepted his employment, the company was new to the marine electronics field and petitioner was unsure about the duration of his employment. While petitioner did not expect that he would be employed by Campbell Management

¹ All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year here in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

² The term petitioner as used herein refers only to petitioner Galo Gourdin.

Corporation's marine electronics division for a long period of time, he hoped that he could move into another division within the Campbell Management Corporation or into a better job with another company if Campbell's marine electronics division proved unsuccessful. In November 1981, petitioner learned that his employment with Campbell Management Corporation would be terminated. Petitioner's employment was in fact terminated on December 30, 1981, due to a restructuring of the management of the Campbell Management Corporation.

During the period from January 29 through March 6, 1981, petitioner commuted to San Diego from his home in Mission Viejo, California, which was a distance of 82 miles each way. From March 7 through May 31, 1981, petitioner spent weekends in Mission Viejo and stayed in motels in San Diego during the week. From June 1 through December 31, 1981, petitioner rented an apartment in San Diego and returned to Mission Viejo on weekends. On his Federal income tax return for 1981, petitioner deducted automobile expenses both for the period during which he commuted to San Diego from Mission Viejo during the week and for his trips to Mission Viejo on weekends, motel lodging expenses, apartment expenses, restaurant and grocery expenses incurred in San Diego, and dry cleaning expenses. In his notice of deficiency, respondent disallowed these deductions.

OPINION

In general, no deduction is allowed for personal living expenses. Sec. 262. However, a taxpayer may be entitled to deduct certain traveling expenses that are (1) ordinary and necessary, (2) incurred while "away from home," and (3) incurred in the pursuit of a trade or business. Commissioner v. Flowers, 326 U.S. 465 (1946); Sec. 162(a)(2). The issue in the instant case is whether petitioner was "away from home" while working in San Diego during 1981 within the meaning of section 162(a)(2).

A taxpayer's "home" is his principal place of business. Kroll v. Commissioner, 49 T.C. 557, 561-562 (1968). If the taxpayer's employment is temporary, however, he is entitled to deduct expenses for meals and lodging under section 162(a)(2). In this context, temporary employment is "the sort of employment in which termination within a short period could be foreseen." Albert v. Commissioner, 13 T.C. 129, 131 (1949). If the termination of the taxpayer's employment cannot be foreseen, however, within a fixed or short period of time, the taxpayer's employment is considered to be indefinite and his expenses are not deductible. Stricker v. Commissioner, 54 T.C. 355, 361 (1970), affd. 438 F.2d 1216 (6th Cir. 1971). The difference between temporary and indefinite employment was considered by the Court of Appeals for the Ninth Circuit in Harvey v. Commissioner,

283 F.2d 491 (9th Cir. 1960), revg. 32 T.C. 1368 (1959). That Court based its holding on whether there was a reasonable probability, known to the employee, that he may be employed for a long period of time at the new place of employment. Harvey v. Commissioner, supra at 495. Thus, in order for petitioner to prevail in the instant case, he must show that he expected his employment in San Diego to be temporary rather than indefinite.³ For later decisions by the Ninth Circuit see Neal v. Commissioner, 681 F.2d 1157 (9th Cir. 1982); Combs v. Commissioner, 608 F.2d 1269 (9th Cir. 1979); Wills v. Commissioner, 411 F.2d 537 (9th Cir. 1969); and Doyle v. Commissioner, 354 F.2d 480 (9th Cir. 1966).

When petitioner accepted his position as sales manager with Campbell Management Corporation, he was uncertain about the potential duration of his employment. He hoped, however, that Campbell Management Corporation would be successful in the marine electronics field or that he would be able to accept another position within the company. He did not become aware that his position would be terminated until November 1981, ten months after he accepted employment. At the time he began his employment with Campbell, petitioner could not foresee that his employment would terminate within a short period of time. Therefore, we hold on these facts that petitioner's employment

³ An appeal of the instant case will lie in the Ninth Circuit. Golsen v. Commissioner, 54 T.C. 742, 757 (1970), affd. 445 F.2d 985 (10th Cir. 1971).

with Campbell Management Corporation was indefinite rather than temporary and that he is not entitled to deduct his travel and living expenses under section 162(a)(2).

Based on concessions of the parties and the foregoing,

Decision will be entered
under Rule 155.

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Jul 11, 7/2: 1986-251

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T. C. Memo. 1986-251

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UNITED STATES TAX COURT

STEPHEN HARMON, Petitioner v. COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 4686-83.

Filed June 19, 1986.

Michael J. Sheber, for the petitioner.

Michael Goldbas, for the respondent.

MEMORANDUM OPINION

WRIGHT, Judge: Respondent determined a deficiency of \$25,726.19 in petitioner's 1977 Federal income tax. This case is before the Court on respondent's motion for partial summary judgment under Rule 121¹ on the issue of whether petitioner may

¹ All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

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deduct an alleged advanced minimum royalty payment.

Petitioner Stephen Harmon resided in Miami Beach, Florida, when the petition was filed herein.

The Huron Coal Program (Huron) was formed in November 1977, for the purpose of acquiring the rights to mine coal in Northumberland County, Pennsylvania. On December 9, 1977, petitioner acquired a one-half working interest in Huron for \$11,000. Simultaneously with that purchase, petitioner entered into the following agreements: a Joint Operating Agreement with Delta Energy Corporation for the management of petitioner's interest in the coal venture; a Sales Agreement with Hoover Coal Sales, Inc., authorizing it to act as sales agent for petitioner; and a Mining Services Agreement with P & P Coal Company granting it the exclusive right to mine the coal on the property leased by Huron.

In addition to the foregoing operating agreements, on December 9, 1977, petitioner, along with the other participants in Huron (the "sublessees"), entered into a sublease with Churchill Coal Corporation (Churchill) as sublessor, for the right to mine coal on a specified tract of land. The term of the sublease is a period of 15 years or until all mineable and merchantable coal has been removed from the property, whichever is later. The sublease provides for the payment of a minimum annual royalty as follows:

Minimum Annual Royalty

(a) Each of Sublessees agrees to pay to Sublessor his pro rata share of a minimum annual royalty (the "Minimum Annual Royalty") with respect to each year of this Sublease of \$219,937 regardless of the amount of coal, if any, which may actually be mined, removed or sold from the Property during such year. The Minimum Annual Royalties payable with respect to the first 10 years of this Sublease, in the aggregate amount of \$2,199,375 (the "Advance Minimum Royalty"), shall be paid by Sublessees simultaneously with the execution of this Sublease in the following manner:

(1) Sublessees shall pay to Sublessor, simultaneously with the execution hereof, in cash the aggregate sum of \$350,000 and

(2) Sublessees shall pay to Sublessor, simultaneously with the execution hereof, by delivering to Sublessor their respective promissory notes of even date herewith, in the form of Exhibit B attached hereto (the "Notes"), the aggregate sum of \$1,849,375. The Minimum Annual Royalty in respect of the tenth year and each succeeding year of this sublease shall be payable on Nov. 30th of each such year at the offices of Sublessor in New York City or at such other place as Sublessor may hereafter designate in writing.

The sublease further provides that payment of the required notes and all other amounts due under the sublease is secured by the "collateral," which consists of the coal, the rights granted to sublessees under the sublease, the improvements, buildings, structures, equipment, machinery, and other personal property of sublessees used in connection with their operations in the specified property, and all proceeds realized from any of the above-described properties. The sublease expressly states that, except as otherwise provided, the sublease shall be without recourse to sublessees and that sublessor shall look only to the collateral for payment of sublessees' obligations thereunder.

Under the sublease petitioner agreed to pay, as his share of the minimum annual royalty, \$4,398.74 for each year of the sublease, and further agreed that the minimum annual royalties payable with respect to the first 10 years of the sublease, the "Advance Minimum Royalty," would be paid upon execution of the sublease. To satisfy this obligation, petitioner paid Churchill \$7,000 in cash and delivered a promissory note for the balance of the aggregate minimum annual royalties. Such note (the "Note") is captioned "Non-Negotiable Promissory Note (Without Recourse)" and states that petitioner shall pay the principal sum of \$39,187 with interest on the unpaid balance at an annual rate of six percent. The Note is payable over a 10-year period, with payments due on or before November 30th of each year, in the following amounts²:

1978	-	\$2,020
1979	-	2,435
1980	-	2,867
1981	-	4,000
1982	-	4,000
1983	-	4,000
1984	-	4,000
1985	-	4,000
1986	-	4,000
1987	-	4,000
1988	-	4,000

The Note further provides that if there is a default in any payment for a period of 12 months after such payment is due and payable, and such default is not remedied within 3 months after

² The stated payments total \$39,322. The difference between this amount and the amount set forth in the Note (\$39,187) is unexplained.

written notice to petitioner, Churchill may declare the entire unpaid principal and the accrued and unpaid interest thereon to be immediately due and payable. The Note is without recourse to petitioner and is secured by petitioner's interest in the sublease. Churchill may look only to the collateral described in the sublease for payment of the Note.

No coal was mined or sold during 1977 on the property leased by petitioner.

On his Federal income tax return for 1977, petitioner claimed a deduction of \$47,159 from his coal mining activities with Huron, of which \$46,188 was attributable to an alleged advanced minimum royalty payment. Respondent disallowed that deduction in its entirety. For purposes of ruling on respondent's motion herein, we are concerned solely with the \$46,188 deduction for advanced minimum royalties.

Summary judgment will be granted under Rule 121 only if the pleadings, affidavits, and other acceptable materials, if any, submitted to the Court show that no genuine issue of material fact exists and that a decision may be rendered as a matter of law. The burden of proving there is no genuine issue of material fact is on the moving party, and factual inferences will be viewed in the light most favorable to the party opposing the motion. Jacklin v. Commissioner, 79 T.C. 340, 344 (1982). Such party must, however, set forth specific facts showing that there is a genuine issue for trial. Rule 121(d).

In his motion for partial summary judgment respondent maintains that the royalties paid in 1977 are not deductible in that year as a matter of law. Specifically, he argues that petitioner's claimed payment in 1977 of \$46,188 was not made pursuant to a minimum royalty provision and concludes that petitioner is not entitled to a deduction therefor.

Alternatively, respondent contends that only that portion of the prepaid minimum royalty which is attributable to 1977 may be deducted in that year. Because we agree with respondent that no payment was made in 1977 pursuant to a minimum royalty provision, we will not herein address respondent's alternative contention.

Generally an advanced royalty is deductible only in the year the mineral product, in respect of which the advanced royalties were paid or accrued, is sold. Sec. 1.612-3(b)(3), Income Tax Regs.; Wendland v. Commissioner, 79 T.C. 355, 386 (1982), affd. 739 F.2d 580 (11th Cir. 1984), affd. sub nom. Redhouse v. Commissioner, 728 F.2d 1249 (9th Cir. 1984). However, a current deduction is allowed when the advanced royalty is paid or accrued "as a result of a minimum royalty provision." Sec. 1.612-3(b)(3), Income Tax Regs. Because no coal was sold during the year in issue, in order to be deductible the advanced royalty in question must have been paid pursuant to a minimum royalty provision. The requirements for a minimum royalty provision are as follows:

For purposes of this paragraph, a minimum royalty provision requires that a substantially uniform amount of royalties be paid at least annually either over the life of the lease or for a period of at least 20 years, in the absence of mineral production requiring payment of aggregate royalties in a greater amount. [Emphasis added.]

Sec. 1.612-3(b)(3), Income Tax Regs.

To determine whether the requirements for establishing a minimum royalty provision have been met, we must look to the agreement as a whole, along with any pertinent additional information. Wing v. Commissioner, 81 T.C. 17, 39 (1983). This Court has held that where payment of a minimum royalty is made by nonrecourse note, payment of which is contingent upon coal production, there is no enforceable requirement that substantially uniform minimum royalties be paid annually, regardless of production. Oneal v. Commissioner, 84 T.C. 1235, 1240 n. 8 (1985), and cases cited therein. Where a sublease agreement provided for an advanced minimum annual royalty of \$60,000 (\$6,000 for each of the first 10 years of the sublease) to be paid with \$10,000 cash and a nonrecourse note of \$50,000, we held that such agreement did not contain a minimum royalty provision, within the meaning of section 1.612-3(b)(3) of the regulations. Wing v. Commissioner, supra. Although one sentence of the sublease agreement called for annual payments of a specified amount over the life of the lease, that sentence was contradicted by subsequent provisions allowing payment by nonrecourse promissory note, under the terms of which none of the principal was required to be paid for 10 years. We found that

payment of the note was contingent on taxpayer's mining coal and concluded that, because payment was contingent, there was no requirement of annual payment over the life of the lease. Wing v. Commissioner, supra. See also Vastola v. Commissioner, 84 T.C. 969 (1985).

We reached a similar conclusion in Maddrix v. Commissioner, 83 T.C. 613 (1984), affd. 780 F.2d 946 (11th Cir. 1986). There the taxpayer satisfied his obligation to pay a share of the annual minimum royalty by paying to the sublessor \$31,230 in cash and executing a nonrecourse note for \$103,239. The note specified that it was secured solely by the taxpayer's fractional undivided interest in the sublease, the taxpayer was not personally liable for any amounts payable under the note, and for payment the sublessor could look only to the collateral described in the sublease. This Court found that the terms of the note, the sublease, and the private placement memorandum offering working interests in the coal sublease reflected an intention that the taxpayer's note be satisfied out of coal sales proceeds. We concluded, therefore, that there was no enforceable requirement that substantially uniform minimum royalties be paid annually in any event, regardless of production. Maddrix v. Commissioner, supra at 623.

In the instant case, petitioner obligated himself under the sublease to pay his share (\$4,398.74) of the minimum annual royalty and to prepay such royalties attributable to the first 10

years of the sublease. Although the sublease recites that a minimum annual royalty shall be paid with respect to each year of the sublease, it requires payment of such amount payable with respect to the first 10 years of the sublease by means of a nonrecourse note, secured only by the sublease and proceeds therefrom. Thus, to satisfy his obligation under the sublease, petitioner paid Churchill \$7,000 in cash and executed a nonrecourse note in the amount of \$39,187 secured only by his interest in the sublease and the proceeds therefrom. The provisions in the sublease limiting petitioner's liability thereon were consistent with the terms of the Note. The Note provided that petitioner had no personal liability thereunder and that Churchill could look only to the collateral described in the sublease for payment. Notwithstanding the payment schedule set forth in the Note calling for annual payments, said Note is nonrecourse and, in the event of nonpayment, Churchill can proceed only against the sublease and the proceeds therefrom. Further, there is no remedy for any default under said Note unless the default is not cured within 3 months after written notice to petitioner, which notice cannot be given until the default has existed for 12 months. Therefore, a condition of default must have been in existence for at least 15 months before any means of collecting the amounts due under the Note became available to Churchill. Thus, more than one year could elapse between payments.

Under the facts here presented we find no requirement that annual payments be made.³ The documents purporting to establish such requirement instead show that petitioner was under no obligation to make annual payments. We conclude as a matter of law that the royalties paid by petitioner in 1977 were not paid as a result of a minimum royalty provision and, therefore, petitioner is not entitled to a deduction for that year for advanced royalties. Petitioner has not established that there is a genuine issue as to any material fact.

Because our conclusion that there was no requirement that annual payments be made is determinative of the issue presented, we need not address the question of whether the payments called for under the Note were substantially uniform.

In accordance with the foregoing, respondent's motion for partial summary judgment will be granted.

An appropriate order will
be issued.

³ Under the terms of the sublease, petitioner claims an obligation to make annual payments of his share of the minimum annual royalty which share equals \$4,398.74. Even if we were to find that the payments called for under the Note satisfy the requirement that annual payments be made, such payments range in amount from \$2,020 to \$4,000. Not one of such payments equals the amount for which petitioner claims an obligation of annual payment.

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T. C. Memo. 1986-252

UNITED STATES TAX COURT

CLÉVELAND RAMSEY AND GLADYS R. RAMSEY, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 13708-83.

Filed June 19, 1986.

Ps alleged that R conducted a second inspection of Ps' books and records in violation of section 7605(b), I.R.C. 1954, and that R's deficiency notice was arbitrary and capricious since it contained a blanket disallowance of all claimed deductions for failure of substantiation. Held, Ps' motions to shift the burden of proof, which is treated as a motion to shift the burden of going forward with the evidence, and to dismiss and to compel discovery compliance denied.

Clyde R. Maxwell and Russell P. Briesacker, Jr., for the petitioners.

James M. Kamman, for the respondent.

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MEMORANDUM OPINION

NIMS, Judge: This case is before the Court on petitioners' motions to compel discovery compliance and to shift the burden of proof, which is treated as a motion to shift the burden of going forward with the evidence, and to dismiss.

Cleveland Ramsey (petitioner), who worked as a self-employed sales contractor during 1979, and Gladys Ramsey, his wife, timely filed a joint Federal income tax return for 1979 on which they reported an income tax liability of \$2,696. On this return, petitioners claimed substantial business expense deductions.

Sometime in 1981, Lloyd West (West), a tax technician for the Internal Revenue Service, was assigned to examine petitioners' 1979 Federal income tax return. On or about September 10, 1981, petitioners met with West at his office to discuss their 1979 return. Petitioners brought with them several receipts to substantiate some of the business expense deductions they claimed on their 1979 return.

During the course of this meeting, petitioner offered West a bribe in exchange for a favorable audit report. Following the conclusion of the meeting, West informed the Inspection Division of the Internal Revenue Service of petitioner's bribe. The Inspection Division directed West to prepare examination reports for petitioners' 1979 taxable year pursuant to the documentation submitted by petitioner so that they could investigate

petitioner's bribe. West suspected the credibility of petitioners' documentation and would not have issued these reports but for the Inspection Division's request.

In an examination report dated September 10, 1981, West determined a deficiency of \$14,567.82 in petitioners' 1979 income tax. In the examination report, West disallowed the following business expenses for lack of substantiation: depreciation--\$3,600; miscellaneous expenses--\$3,333; repairs--\$6,000; miscellaneous expenses--\$2,487; contract labor--\$20,000; and medical and dental--\$1,062.¹

West subsequently mailed to petitioners a Form 4564 (Information Document Request) dated September 15, 1981, in which he requested that petitioners disclose the following documents:

- A) Bank Statements
 - 1. Personal Savings and Checking
- B) Provide Original Purchase Document for Item (Transportation Equipment) Depreciation Claimed On
- C) Verification for Car Expense
 - 1. Cancelled Checks, Invoices, Etc.

As a result of documentation subsequently submitted by petitioners, West prepared a second examination report dated September 21, 1981, in which he determined a deficiency of

¹ Petitioners' medical expense deduction was adjusted to take into account the limitation on medical expense deductions contained in section 213.

Unless otherwise indicated, all section references are to sections of the Internal Revenue Code of 1954 in effect for the year in question. All rule references are to the Tax Court Rules of Practice and Procedure.

\$11,027.86 in petitioners' 1979 income tax. West mailed this examination report to petitioners together with a second Form 4564 dated September 23, 1981, in which he requested additional documentation of petitioners' claimed business expenses.

On October 28, 1981, West visited petitioner's business office and inspected his books and records. Based on a review of these records and the records previously submitted by petitioners, West prepared an examination report dated October 28, 1981, in which he determined a deficiency of \$7,101.22 in petitioners' 1979 income tax.

On October 29, 1981, petitioner gave West cash of \$1,100 in exchange for an examination report showing a tax liability of \$524. At the time he received the report, petitioner also handed to West a check in the amount of \$524 payable to the Internal Revenue Service.

Petitioner was subsequently arrested, indicted and tried for bribery. The trial resulted in petitioner's acquittal.

On or about October 1, 1982, following petitioner's acquittal, petitioners' 1979 income tax return was assigned to Richard Stephens (Stephens), a tax technician for the Internal Revenue Service. Stephens received the administrative file which West had compiled in connection with the initial examination of petitioners' return. Although the file contained the documentation previously submitted by petitioners, Stephens was informed that some of the documents were false. Because of the

false documentation and to ensure that petitioners would be treated fairly and not prejudiced by petitioner's prior criminal investigation, Stephens decided to initiate a new examination of petitioners' 1979 tax return. By letter dated November 1, 1982, Stephens informed petitioners that:

The examination of your 1979 Federal income tax return has been assigned to me for completion. To be sure that the examination is not unfairly influenced by any of the participants in the previous criminal action, the examination has been moved to our West Los Angeles office, located at 11390 W. Olympic Blvd., 4th floor.

* * *

None of the previous audit determinations will be used and you will be given the opportunity to start the examination all over. Please have with you when you come in all the information originally. Specifically, have with you all bank records for all accounts (both business and personal, and including all checking, savings and loan accounts). Also have with you verification of: 1) any non-taxable income you received in 1979; 2) cost of goods sold; 3) all labor costs; 4) supplies and materials; 5) canvancers; 6) out of state travel; 7) travel & entertainment; and 8) any purchases qualifying for investment tax credit in 1979.

By letter dated November 23, 1982, petitioners' counsel informed respondent that he objected to any reinspection of petitioners' books and records. Upon receipt of this letter, Stephens contacted his manager to determine if his actions would, in fact, constitute a reinspection of petitioners' books and records. Stephens and his manager determined that because the initial examination of petitioners' income tax return had been interrupted by the bribery investigation and never closed, Stephens' examination was a continuation of the original

examination and, therefore, did not constitute a reinspection of petitioners' books and records. As a precautionary measure, however, Stephens issued to petitioners a reopening memorandum dated December 15, 1982, which provided as follows:

We are required by law to notify a taxpayer in writing if we need to reexamine his books and records after previously examining them.

Because information that may affect your tax liability has been developed since we last examined your books and records, please make them available to us for reexamination.

Stephens enclosed with this letter an examination report dated December 15, 1982, in which he determined a deficiency of \$20,395 in petitioners' 1979 Federal income tax and an addition to tax under section 6653(a) in the amount of \$1,020. This deficiency resulted from respondent's disallowance of certain business expenses claimed by petitioners for lack of substantiation. On April 11, 1983, respondent issued a notice of deficiency based on Stephens' examination report. Neither petitioners nor their counsel ever produced any books and records for Stephens' examination. On June 6, 1983, petitioners timely filed a petition with this Court in which they contested respondent's deficiency determination and additions to tax.

On November 23, 1984, petitioners' counsel served respondent with a first request for admissions. On November 30, 1984, petitioners' counsel served respondent with a first set of interrogatories and a first request for production of documents. On December 24, 1984, respondent filed a motion for protective

order on the grounds that petitioners' counsel had not requested an informal discovery conference and respondent had not denied petitioners' right to such conference. By order dated January 4, 1985, we calendared respondent's motion for hearing at the Court's Los Angeles, California, trial session beginning on February 4, 1985.

On January 7, 1985, petitioners filed a motion to compel discovery compliance. By order dated January 10, 1985, we calendared petitioners' motion for hearing at the Court's Los Angeles, California, trial session beginning on February 4, 1985. The motion hearing was held on February 6, 1985. After hearing arguments for both sides, we suggested that respondent's counsel allow counsel for petitioners to review the administrative file respondent had compiled in connection with his examination of petitioners' 1979 income tax return. Counsel for respondent agreed to allow petitioners' counsel to review the administrative file. We then took respondent's motion for a protective order and petitioners' motion to compel discovery compliance under advisement.

In February, 1985, petitioners' counsel reviewed the administrative file for petitioners' taxable year 1979, marked the documents he wanted photocopied and returned the file to respondent who then photocopied the designated documents and mailed them to petitioners' counsel.

On March 11, 1985, petitioners' case was called from the calendar of the Court's Los Angeles, trial session. Counsel for petitioners filed a motion to shift the burden of going forward and dismiss on the grounds that (1) the notice of deficiency is arbitrary and capricious; and (2) respondent conducted an unlawful second inspection of petitioners' 1979 income tax return in violation of section 7605(b). By order dated March 11, 1985, we continued the hearing on respondent's motion.

On July 15, 1985, this case was called from the trial calendar of the Court's special trial session at Los Angeles, California. We set petitioners' motions for hearing on July 22, 1985, and continued the trial of this case generally. Counsel for both parties appeared at the July 22, 1985 motions hearing.

Motion to Shift the Burden of Going Forward and to Dismiss

The first issue for decision is whether we should grant petitioners' motion to shift the burden of going forward and to dismiss. In this motion, petitioners contend that respondent issued the notice of deficiency after making a second inspection of their books and records in violation of section 7605(b). Petitioners further contend that this section 7605(b) violation renders respondent's notice of deficiency void. Petitioners therefore conclude that an order should be issued dismissing this case with a determination that there is no deficiency in their 1979 income tax. Alternatively, petitioners contend that respondent arbitrarily denied the business expenses they claimed

on their 1979 income tax return. Petitioners therefore maintain that respondent should bear the burden of going forward to show that petitioners are not entitled to their claimed deductions.

We must first decide whether respondent made a second inspection of petitioners' books and records in violation of section 7605(b) and, if so, whether such violation renders the subsequently issued notice of deficiency void.

Section 7605(b) provides as follows:

No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

Petitioners concede that neither petitioners nor their counsel ever produced any books and records for Stephens' examination. They contend, however, that even though no records were actually produced for and reinspected by respondent, respondent's request for a second inspection constitutes a violation of section 7605(b). We disagree.

In order to violate section 7605(b), respondent must conduct a second inspection of a taxpayer's books and records without first notifying the taxpayer that an additional inspection is necessary. Ballantine v. Commissioner, 74 T.C. 516 (1980); United States Holding Co. v. Commissioner, 44 T.C. 323 (1965). Petitioners concede in the instant case that their books and records were not made available to respondent for reinspection,

and at no time has respondent made a reinspection of such books and records. Thus, respondent has not made a second inspection of petitioner's books and records and, therefore, has not violated section 7605(b). United States Holding Co. v. Commissioner, supra.

Moreover, even if petitioner had allowed respondent to reinspect his books and records, respondent would not be in violation of section 7605(b). Respondent notified petitioners by letter dated December 15, 1982, that a second inspection of their books and records would be necessary in light of petitioner's previous criminal prosecution. Thus, even if respondent's request for a second inspection was tantamount to an actual second inspection, which it is not, respondent gave petitioners prior written notice of his intent to conduct a second inspection and, therefore, would not be in violation of section 7605(b). Having found that respondent did not conduct a second inspection in violation of section 7605(b), we need not decide whether a section 7605(b) violation would have rendered respondent's notice of deficiency void. Petitioners' motion to dismiss is denied.

Petitioners alternatively request that we find that respondent was arbitrary and capricious in not allowing their business expense deductions, and, therefore, that the burden of going forward in this case should be shifted to respondent. Petitioners' request, however, in essence asks the Court to look behind respondent's notice of deficiency. As a general rule,

this Court will not look behind a deficiency notice to examine the evidence used or the propriety of respondent's motives in making the determination. Greenberg's Express, Inc. v. Commissioner, 62 T.C. 324, 327-329 (1974); Suarez v. Commissioner, 58 T.C. 792, 813 (1972). The rationale for this rule is that a trial before the Tax Court is a proceeding de novo, and our decision is based on the merits of the case rather than on any previous record developed at the administrative level. Jackson v. Commissioner, 73 T.C. 394, 400 (1979).

This Court has recognized a rare exception to this general rule in unreported illegal income cases in which respondent presents no substantive evidence. Jackson v. Commissioner, supra. The rationale for this exception is that a taxpayer should not bear the burden of proving a negative if the Commissioner can present no admissible evidence connecting the taxpayer with the putative source of income upon which the deficiency determination is based. See Gatlin v. Commissioner, 754 F.2d 921 (11th Cir. 1985), affg. per curiam T.C. Memo. 1982-489. Petitioners, however, do not fall within this exception.

The deficiency in the instant case did not result from respondent's determination that petitioners had unreported income. Rather, the deficiency in issue resulted from respondent's determination that petitioners had failed to substantiate certain business expenses claimed by them on their 1979 income tax return. Only petitioners are privy to the facts

necessary to substantiate their claimed deductions. Consequently, it is only logical that petitioners, not respondent, shall bear the burden of proof as well as the burden of going forward. Petitioners' motion to shift the burden of going forward to respondent is denied.

Motion to Compel Discovery Compliance

Although petitioners' counsel was allowed to examine the examination file compiled by respondent in connection with his investigation of petitioners' 1979 income tax return, petitioners maintain in their brief that respondent has not disclosed all of the documents set forth in their discovery requests. Specifically, petitioners contend that respondent has not completely disclosed the file compiled by the Inspection Division in connection with its criminal investigation of petitioner's bribe of Agent West nor has he disclosed certain receipts, memoranda and cancelled checks relied on by Agent Stephens to prepare his examination report. Petitioners contend that this evidence is necessary to establish the basis for respondent's notice of deficiency. For the reasons stated above, however, this Court will not look behind respondent's deficiency notice, and, therefore, any evidence concerning the basis for respondent's determination is not relevant to the disposition of the instant case. Because Rule 70(b) limits the scope of discovery to "any matter * * * which is relevant to the subject matter involved in the pending case," evidence concerning the

basis for respondent's deficiency determination is outside of the scope of discovery. Consequently, petitioners' motion to compel discovery compliance is denied.

To reflect the foregoing,

An appropriate order will
be issued.

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T. C. Memo. 1986-253

UNITED STATES TAX COURT

PHILIP JAMES RUGARE AND BRIGITTE MARIA RUGARE PAUK, Petitioners,
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 18921-80.

Filed June 19, 1986.

Petitioners were married and filed joint Federal income tax returns for the taxable years in issue. As a result of a police investigation conducted at petitioner-wife's place of employment, petitioner-wife was convicted of grand theft, on a plea of nolo contendere, and served time in a detention center.

Held, petitioners have failed to carry their burden of proof with respect to the deficiency determined for failure to report income from embezzled funds, in accordance with sec. 61, I.R.C. 1954. Held further, petitioner-husband has failed to establish that he is entitled to relief from such liability as an innocent spouse, within the meaning of sec. 6013(e).

Philip James Rugare and Brigitte Maria Rugare Pauk, pro se.

Sharon C. Armuelles, for the respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

STERRETT, Chief Judge: Respondent determined by notice of deficiency dated July 25, 1980 deficiencies in the Federal income taxes of petitioners and additions to tax for the taxable years ended December 31, 1977 and December 31, 1978 as follows:

<u>Taxable Year</u>	<u>Deficiency</u>	<u>Additions to Tax Section 6653(a)¹</u>
1977	\$ 1,015.00	\$ 50.75
1978	15,150.19	757.51

After concessions,² the primary issue for decision is whether petitioners have failed to report income in accordance with section 61 in the 1978 taxable year based upon embezzled funds. Also at issue is whether one of the petitioners is relieved from liability as an "innocent spouse," within the meaning of section 6013(e).

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulated facts and exhibits attached thereto³ are

¹ Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the taxable years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

² Petitioners do not contest the deficiencies determined by respondent based upon unreported tip income and additions to tax for negligence under section 6653(a) for the 1977 and 1978 taxable years.

³ We note that, although the transcript indicates that the parties submitted their stipulation of facts with only joint exhibits A-1 through D-4 attached and at trial petitioners' exhibit "5" was identified but not received in evidence, the joint exhibits number A-1 through E-5, and the stipulation of facts refers specifically to "Joint Exhibit E-5" attached thereto.

incorporated herein by this reference.

Petitioners Philip James Rugare (Philip) and Brigitte Maria Rugare Pauk (Brigitte) were husband and wife during the 1977 and 1978 taxable years and filed joint Federal income tax returns with the Internal Revenue Service Center in Atlanta, Georgia. Petitioners were divorced sometime after 1978. The parties have stipulated that at the time petitioners filed their petition in this case their residence was Lauderhill, Florida.⁴

From sometime in December 1977 until June 18, 1978, Brigitte was employed as a hostess and cashier at "Ireland's Inn" restaurant (the Inn), located in Ft. Lauderdale, Florida. Her duties there included some responsibility for cash and credit card (charge) payments for services at the restaurant's bar and dining rooms. At times, she also was responsible for completing the daily tally sheets, closing out the cash registers, and delivering the cash, bills, tally sheets, and register receipts to the restaurant office.

The Inn utilized two cash register machines in its restaurant and bar service. First, orders for food and drinks were entered into a cash register known as a "pre-check machine." Upon payment, the order was entered into a regular cash register located on a different floor of the restaurant. Daily totals on

⁴ Although the amended petition also listed both petitioners' residences as Lauderhill, Florida, petitioners stated in their original petition that Philip resided in Florida but Brigitte resided in Kansas. However, we do not undertake to resolve the issue of petitioners' proper venue for appeal. See Brewin v. Commissioner, 72 T.C. 1055, 1058-1060 (1979), revd. on another issue 639 F.2d 805 (D.C. Cir. 1981).

each of the two machines should have been identical. Any amount entered incorrectly into a register could have been corrected by voiding out the erroneous entry. All voids were supposed to be authorized by the manager or chef on duty at the time. Totals recorded on the two machines would not balance if, for example, payments for orders previously entered into the pre-check machine were not entered into the regular cash register. However, if those same orders also were voided out of the pre-check machine then the totals for the two machines again would balance.

In June 1978, a night auditor employed by the Inn noticed discrepancies between the totals recorded on two cash register machines. The auditor reported this to the Inn's manager and accountant, who then discovered many unauthorized voids recorded on the pre-check register. A police investigation followed thereafter, based upon a sworn statement to an investigator with the Ft. Lauderdale police department by one of the Inn's waitresses. The waitress stated that she had observed Brigitte's failure to enter payments into the regular cash register, and also had noticed a large number of consecutive voids on the cash register receipt tapes. Based on information contained in the police report filed pursuant to this investigation, the Inn's manager prepared a chart that listed all of the voids recorded on the pre-check register from January 1, 1978 through June 19, 1978. The chart provided that the voids totaled \$39,598.74 for the 119 days that Brigitte worked at the Inn, as compared with \$2,900.07 for the 49 days that she did not work during this same

time period. The Inn's accountant also prepared a list of all void transactions recorded on the pre-check register for the same time period based on the police report.

As a result of the police investigation, Brigitte was charged with grand theft under Florida Statute sec. 812.014. On April 17, 1979, she entered a plea of nolo contendere to the charge and was sentenced to 1 year in jail and 4 years probation. She served 5-1/2 months of this sentence at the Broward County Women's Detention Center in Broward County, Florida.

In the statutory notice of deficiency, respondent determined deficiencies in petitioners' Federal income taxes and additions to tax for the 1977 and 1978 taxable years. The primary issue remaining for decision is whether petitioners have failed to report income in 1978 based upon funds embezzled by Brigitte from her employer. Also at issue is whether Philip may be relieved from any liability here as an innocent spouse.

OPINION

The primary issue for decision is whether respondent has correctly determined that petitioners have failed to report income in 1978 from embezzled funds. It is well established that gains from illegal sources constitute gross income under section 61,⁵ sec. 1.61-14(a), Income Tax Regs., and that embezzled funds are includable in income to the embezzler in the year in which

⁵ SEC. 61. GROSS INCOME DEFINED.
(a) General Definition.--Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, * * *.

they are misappropriated. James v. United States, 366 U.S. 213, 219-220 (1961). Respondent argues that petitioners have failed to report \$32,515.96 in income that was stolen by Brigitte from her employer, Ireland's Inn restaurant. Petitioners argue that Brigitte never stole any money from her employer, and that they have not failed to report any income for 1978. Petitioners bear the burden of proving that respondent's determination of the amount of the deficiency is erroneous. Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933).

As a result of the police investigation conducted with respect to unauthorized cash register procedures at the Inn, Brigitte was convicted of grand theft based upon a plea of nolo contendere and served time in a detention center. This Court follows the rules of evidence applicable in nonjury trials in the United States District Court for the District of Columbia, (sec. 7453; Rule 143(a)), which provide that a conviction of nolo contendere may be used to impeach the credibility of a witness. Rule 609(a), Fed. R. Evid.; Masters v. Commissioner, 243 F.2d 335, 338 (3d Cir. 1957), affg. 25 T.C. 1093 (1956); Kilpatrick v. Commissioner, 227 F.2d 240, 243 (5th Cir. 1955), affg. 22 T.C. 446 (1954); Hicks Co. v. Commissioner, 56 T.C. 982, 1027 (1971), affd. 470 F.2d 87 (1st Cir. 1972).⁶

⁶ See also United States v. Dennis, 532 F.Supp. 625 (E.D. Mich. 1982).

At trial Brigitte testified that there were a total of approximately 11 waiters and waitresses, 4 busboys, and 3 cocktail waitresses, all of whom had access to the cash register in the kitchen. Philip also testified that other employees besides Brigitte had access to the cash, charges, and daily tally sheets. The parties agree that Brigitte was only "sometimes" responsible for the cash and charge payments, daily tally sheets, closing out the cash registers, and delivering the cash and other receipts to the restaurant office. However, petitioners have failed to offer any explanation as to why the voids recorded on the cash registers for those days that Brigitte worked were so far in excess of the voids recorded on those days that she did not work, as set forth in the charts prepared by the restaurant's manager and accountant. Brigitte merely stated that she was not the only employee responsible for the cash registers and that she worked primarily in the upstairs dining room rather than in the kitchen where the cash register was located. At trial Brigitte stated that she did not offer this explanation to the police during their investigation because she "didn't have a chance." She also stated that she did not give this explanation to the Internal Revenue agent who spoke with her while she was serving her prison sentence for this offense, simply because "he didn't ask" her.

We conclude that petitioners' testimony is not credible as it consists entirely of unsupported and self-serving statements. Petitioners also argue that the exact amount of any monies

misappropriated from the Inn has never been determined. However, petitioners have failed to present any evidence whatsoever to cause us to reduce the amount of the determined deficiency. See Fox v. Commissioner, 61 T.C. 704, 711-712 (1974). Accordingly, we find that petitioners simply have failed to carry their burden of proof with respect to this issue.

We next must address whether Philip may be relieved from liability as an innocent spouse. As a general rule, where a husband and wife file a joint tax return, liability with respect to the tax shall be joint and several. Sec. 6013(d)(3). However, section 6013(e)⁷ provides that a spouse may be relieved of such joint liability, where, on a joint return, there is a "substantial understatement" of tax attributable to "grossly erroneous items" of one spouse, and the other spouse establishes that in signing the return he or she did not know or have reason to know of such understatement, and that it would be inequitable to hold that other spouse liable for the deficiency attributable thereto.⁸ Philip bears the burden of proving that all of these

⁷ Section 6013(e), as amended by the Deficit Reduction Act of 1984, Pub. L. 98-369, sec. 424(a), 98 Stat. 494, 801-802 (1984-3 C.B. (Vol. 1) 309-310), has retroactive application to all taxable years to which the Internal Revenue Codes of 1939 and 1954 apply. See H. Rept. 98-432, Pt. 2 1501, 1503 (Mar. 5, 1984).

⁸ Section 6013 provides in relevant part as follows:

(e) Spouse Relieved of Liability in Certain Cases.--

(1) In general.--Under regulations prescribed by the Secretary, if--

(A) a joint return has been made under this section for a taxable year,

(footnote continued)

elements are met. Lessinger v. Commissioner, 85 T.C. 824, 838 (1985).

Philip has not presented any argument with respect to relief as an innocent spouse, other than to raise the issue in the original petition. Additionally, we note that at trial Philip testified at some length with respect to the determined deficiency. He stated that he and Brigitte had discussed the circumstances surrounding her employment at, and firing from, the Inn, and that Brigitte "went into detail" with respect to these events. Based upon the degree of Philip's self-professed familiarity with the events surrounding the unreported income, we would be hard pressed to find either that Philip did not know, or had no reason to know, of the understatement in petitioners' tax liability or, that it would be inequitable to hold him jointly liable therefor.

(footnote continued from previous page)

(B) on such return there is a substantial understatement of tax attributable to grossly erroneous items of one spouse,

(C) the other spouse establishes that in signing the return he or she did not know, and had no reason to know, that there was such substantial understatement, and

(D) taking into account all the facts and circumstances, it is inequitable to hold the other spouse liable for the deficiency in tax for such taxable year attributable to such substantial understatement,

then the other spouse shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent such liability is attributable to such substantial understatement.

Accordingly, we conclude that Philip has failed to satisfy the requirements of section 6013(e), and is not entitled to relief as an innocent spouse.

Decision will be entered
for the respondent.

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T. C. Memo. 1986-254

UNITED STATES TAX COURT

WILLIAM P. SMITH, Petitioner v. COMMISSIONER OF
INTERNAL REVENUE, Respondent

Docket Nos. 1759-82, 22930-84. Filed June 19, 1986.

William P. Smith, pro se.

Patrick E. McGinnis and Dorothy W. Westover, for the
respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

CLAPP, Judge: In statutory notices of deficiency,
respondent determined deficiencies in and additions to
petitioner's Federal income tax as follows:

Docket No.	Year	Deficiency	Additions to Tax	
			I.R.C. Sec. 6653(b) ¹	Sec. 6654
1759-82	1971	\$ 8,808.97	\$ 4,404.49	\$ 157.13
	1972	25,677.38	12,838.69	818.45
22930-84	1975	13,928.00	6,964.00	602.00
	1976	20,389.00	10,194.00	689.00
	1977	21,364.00	10,682.00	760.00
	1978	31,933.00	15,966.00	1,019.00

In his answer in Docket No. 22930-84, respondent alleged increased deficiencies for years 1975 through 1978 in the amounts of \$16,801, \$23,418, \$24,402 and \$35,086, respectively, and corresponding increases in additions to tax under section 6653(b) and section 6654.

In these consolidated cases, after concessions by petitioner, the issues for decision are: (1) whether petitioner received unreported currency income in the amounts determined by respondent; (2) whether petitioner is liable for the additions to tax under section 6653(b) for fraud; and (3) whether petitioner is liable for the additions to tax under section 6654.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly. The stipulation of facts and attached exhibits are incorporated herein by this reference.

Petitioner, William P. Smith, resided in California when he filed the petitions herein.

¹ Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and all rule references are to the Tax Court Rules of Practice and Procedure.

During the years 1971 through 1978, petitioner was a Doctor of Dental Surgery with a private practice located in Fullerton, California. During this time petitioner was married to Ruthe A. Smith under the laws of California. Mrs. Smith was the office manager and bookkeeper for petitioner's dental practice from 1971 through 1977. Vicky Teague then became the bookkeeper. Petitioner received payment from his patients in the form of check or cash currency. Most of the checks were deposited in the bank and were duly recorded on a journal captioned "record of cash received" (hereinafter referred to as the cash receipts journal). Occasionally petitioner would endorse a check and receive currency. Payments in currency were not recorded in the cash receipts journal but were recorded on each patient's chart. During 1971 and 1972 petitioner received approximately \$100 a day in undeposited currency.

Beginning 1964 petitioner engaged Richard Wilbur as his accountant. Wilbur prepared petitioner's 1969 and 1970 Federal income tax returns. Wilbur also prepared a general ledger for petitioner's dental practice for the years 1971 and 1972. The cash receipts journal was the basis for the entries made on the general ledger for the income received. Wilbur was not aware that the cash receipts journal did not reflect the currency received in petitioner's practice.

Early in 1972, petitioner advised Wilbur that he did not intend to file a tax return for 1971. Petitioner invited Wilbur to attend a meeting of tax protestors. After the meeting,

petitioner and Wilbur agreed that Wilbur would no longer do petitioner's accounting. Wilbur prepared the general ledger through November 1972. Petitioner prepared a Form 1040 for the year 1971 utilizing the records prepared by Wilbur. In July 1972, petitioner submitted this Form 1040 to Crocker National Bank to verify his application for a professional loan. Petitioner indicated on this form that his adjusted gross income was \$48,373. However, petitioner never submitted this form to the Internal Revenue Service.

Instead, petitioner submitted to the Internal Revenue Service a Form 1040, dated April 10, 1972, and received on May 8, 1972, which purported to be a Federal income tax return for the year 1971 but was blank on the lines requesting information as to income and tax liability. The words, "[u]nder penalties of perjury" were deleted and the form contained a notation, "Objections to Form of Return," reciting invasion of privacy under the Fourth Amendment, possible self-incrimination under the Fifth Amendment and that petitioner had received no income in valid constitutionally legal dollars redeemable in gold and silver. A letter was sent to petitioner dated September 14, 1972, advising petitioner that the form submitted was not an acceptable return and cited the case of United States v. Porth, 426 F.2d 519 (10th Cir. 1970).

Petitioner and his wife submitted a Form 1040, dated April 16, 1973, which purported to be a Federal income tax return for the year 1972 but again contained blank lines as to income and

tax liability and noted the same objection. Again the Internal Revenue Service sent a letter, dated July 2, 1973, to petitioner and his wife advising that the submitted form was not a return.

In January 1973, Wilbur received a summons from special agents of the Internal Revenue Service for petitioner's records. Wilbur, after speaking with his attorney about a possible defect in the summons, called petitioner who then came to Wilbur's office and removed his records. In September 1973, petitioner was contacted by a special agent. Petitioner was uncooperative in answering the agent's questions. On November 13, 1973, petitioner telephoned the special agent and asked for the forms necessary to file an amended return. On March 19, 1974, the Fresno Service Center received Forms 1040X, dated March 14, 1974, and signed by petitioner and his wife, purporting to be amended tax returns for the years 1971 and 1972, but again contained no information on income or tax liability. Attached to the forms were pages of frivolous protest material.

In June 1972, petitioner stopped withholding income tax and FICA from the wages of his dental assistant and his receptionist, and failed to provide them with a W-2 Form. Petitioner encouraged his employees, patients and other physicians to stop paying Federal income taxes and to join the tax protest movement.

On September 13, 1976, petitioner pled guilty to the offense of failure to collect and pay over taxes for calendar quarter ending in 1972 in violation of section 7202. Petitioner was placed on probation for three years. Petitioner stated to Dr. Kirby, another dentist in petitioner's office, that because of his guilty plea he would have to pay back taxes. However, he admitted that the Internal Revenue Service's estimate would be too low because the only accurate records were the patients' charts which were unavailable to the Service without each patient's permission.

For the taxable years 1975 through 1978, petitioner did not file tax returns. In the early part of 1979, petitioner submitted Forms 1040 and Forms 1040X for the years 1975, 1976, and 1977, which contained on every line pertaining to income and tax computation the words "Object - 5th amendment right against self-incrimination." On June 21, 1983, petitioner pled guilty to the willful failure to file an income tax return for the year 1978 in violation of section 7203.

On March 17, 1983, when agents of the Internal Revenue Service attempted to serve a grand jury subpoena on Vicky Teague, petitioner's receptionist and bookkeeper, petitioner interceded and instructed Teague not to take the subpoena. It was only after petitioner called the police who admonished petitioner that the agents had a right to be there that Teague took the summons.

Petitioner failed to provide any records to the Service upon which a correct tax could be computed. Petitioner destroyed the patient charts in 1979.

In the notice of deficiency relating to years 1971 and 1972, issued on November 13, 1981, respondent determined, based on bank deposits and currency income of \$24,000, the gross receipts from the business in the amounts of \$153,068.91 and \$176,305.84. Business expenses and partnership losses were deducted to derive adjusted gross income. One-half of the adjusted gross income was attributed to petitioner and the other half to his wife pursuant to the community property laws of California. The taxable income attributed to petitioner equals \$24,304.85 and \$55,814.42 in years 1971 and 1972, respectively. In the notice of deficiency issued on April 9, 1984, relating to years 1975 through 1978, respondent determined the gross receipts from the business based on bank deposits and currency payments and petitioner's amount of taxable income (one-half of income and deductions were attributable to his wife) as shown below:

	<u>Gross receipts</u>	<u>Amount of currency included in gross receipts</u>	<u>Taxable income</u>
1975	\$148,031.07	0	\$33,208.17
1976	187,434.12	302.00	44,541.59
1977	191,624.11	335.00	47,500.08
1978	242,811.53	547.40	64,379.38

Additions to tax under section 6653(b) and section 6654 were also determined in both notices. In the answer filed in docket No. 22930-84, respondent alleged that petitioner received currency in

the amount of \$10,400 for each year 1975 through 1978 based on the receipt of \$200 per week in currency from patients, resulting in increased deficiencies and additions to tax.

OPINION

Petitioner has conceded that the notice of deficiency correctly computes the amount of taxable deposits and income using the bank deposits method for the years in question, with the exception of the amount of unreported, undeposited currency income. Petitioner has also conceded that the notices of deficiency correctly compute the allowable itemized deductions, business expenses and allowable partnership deductions and income.

The notice of deficiency with respect to the years 1971 and 1972 alleges that a currency amount of \$24,000 was received in petitioner's business for each of those years. The notice of deficiency is presumed correct and the burden is on petitioner to show that a lesser amount of currency was received than what was alleged in the notice of deficiency. Rule 142(a). However, with respect to the years 1975 through 1978, the burden is on respondent to show that the amounts alleged in the answer, i.e., \$10,400 each year, is correct rather than the smaller amounts in the notice. The only testimony presented to establish the amount of currency was that of the dental assistant, Elizabeth Blake, and the assistant bookkeeper, Kay Emerson, who worked for petitioner during the years 1971 and/or 1972. Ms. Blake, who was not responsible for the bookkeeping, estimates that petitioner

received approximately \$60 a day. Ms. Emerson, who wrote out the receipts for patients, estimated that the amount of currency received was \$100 per day. We found her testimony credible. Respondent stated at trial that the amount in the notice of deficiency was based on a figure of \$100 a day. Computing on the basis of 240 working days this amounts to \$24,000 a year. Petitioner has failed to prove that a lesser amount was received. On brief, however, respondent claims that petitioner received \$20,400 for each of the years at issue, 1971, 1972, 1975, 1976, 1977 and 1978, based on an estimate of \$100 a day. We do not understand why the amount was lowered from \$24,000 to \$20,400 for the years 1971 and 1972, and we do not believe that respondent intended to concede these amounts. Accordingly, respondent's determination in the notice of deficiency is sustained with respect to the years 1971 and 1972.

With respect to the years 1975 through 1978, respondent by answer determined that the currency received was \$10,400 each year. As noted above, respondent on brief increased this amount to \$20,400 each year. Respondent relies on the fact that the office procedures were unchanged from the years 1971 and 1972 to years 1975 through 1978. While we agree that petitioner continued to receive currency which was not deposited in the bank during these years, this fact alone is not sufficient to satisfy respondent's burden to show the amount. Petitioner, however, conceded at trial that he received each year an amount at least equal to the \$10,400 amount alleged in respondent's answer.

Petitioner on brief states that he conceded receiving \$20,400 but he does not state for what period of time. Based on his statements at trial, we do not understand why the amount was raised from \$10,400 to \$20,400 and we do not believe that petitioner intended to concede this higher amount. Based on petitioner's concession at trial, we find that petitioner received \$10,400 a year of unreported, undeposited currency income for the years 1975 through 1978 as determined in respondent's answer.

The next issue for decision is whether petitioner is liable for the addition to tax under section 6653(b) for fraud. Respondent bears the burden of proving by clear and convincing evidence that petitioner has an underpayment of tax, and that some part of this underpayment is due to fraud. Section 7454(a); Rule 142(b). This burden is met if it is shown that the taxpayer intended to conceal, mislead or otherwise prevent the collection of such taxes. Rowlee v. Commissioner, 80 T.C. 1111, 1123 (1983). Fraud is a factual question to be determined upon consideration of the entire record, Gajewski v. Commissioner, 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978). Fraud is never presumed. Beaver v. Commissioner, 55 T.C. 85 (1970). Fraud may, however, be proved by circumstantial evidence because direct proof of the taxpayer's intent is rarely available. The taxpayer's entire course of conduct may establish the fraudulent intent. Stone v. Commissioner, 56 T.C. 213, 223-224 (1971).

Respondent need not prove the precise amount of underpayment resulting from fraud, but only that there is some underpayment and that some part of it is attributable to fraud. Plunkett v. Commissioner, 465 F.2d 299, 303 (7th Cir. 1972), affg. a Memorandum Opinion of this Court.

Respondent has carried his burden of proving that there was an underpayment of tax for each of the years in question. The record is clear and petitioner has in fact stipulated that he received sufficient taxable income to produce an underpayment of tax for the years in question.

Respondent has also carried his burden of proving that the underpayments were due to fraud. Petitioner understood his obligation to file tax returns and report his income from his dental practice as shown by his filed returns in 1969 and 1970. Yet, petitioner failed to file valid Federal income tax returns for the years at issue. United States v. Klee, 494 F.2d 394, 397 (9th Cir. 1974); United States v. Porth, 426 F.2d 519 (10th Cir. 1970). In support of his loan application at Crocker National Bank, he submitted a completed Form 1040 as his tax return. Thus, he was aware that the Porth-type return was unacceptable. Petitioner's wholesale use of the Fifth Amendment privilege against self-incrimination is wholly unwarranted. To claim the privilege, the taxpayer must be faced with substantial hazards of self-incrimination that are real and appreciable, and must have reasonable cause to apprehend such danger. United States v. Neff, 615 F.2d 1235, 1239 (9th Cir. 1980). There is no

indication that the furnishing of information regarding the amount of petitioner's income would reveal criminal activity in his dental practice. The privilege may not itself be used as a method of evading payment of lawful taxes. Edwards v.

Commissioner, 680 F.2d 1268, 1270 (9th Cir. 1982). Petitioner admitted at trial that when he began to pocket the currency, he stopped filling out the Forms 1040 in the proper manner.

In order to conceal the receipt of currency, petitioner maintained a double set of books. The cash receipts journal only recorded checks received and deposited in the bank. This journal was submitted to petitioner's accountant as a record of petitioner's gross receipts from his practice.² However, the patients' charts were the only accurate records reflecting the amount of income, both checks and currency, received. Petitioner's maintenance of a double set of books is persuasive evidence of fraud. Stone v. Commissioner, supra at 213.

Petitioner also obstructed the investigation of the Internal Revenue Service. He failed to provide information to the agents. He wrested his records away from his accountant when informed of the Internal Revenue Service summons. Petitioner also admits to having destroyed the patients charts in 1979, the only records

² To support the determination of fraud, respondent relies on petitioner's withholding of information from his accountant. While this type of conduct may be indicative of fraud in some cases, we do not believe this factor is particularly relevant in this case inasmuch as it is agreed that Wilbur did not prepare a return for petitioner in any of the years in question. The records in Wilbur's possession do support respondent's allegation that petitioner maintained a double set of records in his dental practice.

which would accurately reflect the income from his practice. Petitioner's obstruction of the investigation and the destruction of records is highly indicative of fraud. Stone v. Commissioner, supra.

Petitioner was an intelligent, highly educated individual who was aware of his obligation to pay taxes. Yet petitioner deliberately set upon a course of conduct, and encouraged others to do the same, to evade the payment of taxes. Accordingly, we find that the underpayments of tax for the years in question were due to fraud.

Section 6654

Petitioner bears the burden of proving that respondent erred in determining petitioner is liable for additions to tax under section 6654. Rule 142(a). Petitioner made no attempt to carry his burden and introduced no evidence that would show respondent's determination is incorrect. We sustain respondent's determination.

Decisions will be entered
under Rule 155.

